Sales Tax Collection Allowance

Introduction

During the 2006 legislative session, the Legislature enacted HB 1110 which created a program providing vendor compensation for collecting and remitting the sales tax to the state which may also be referred to as a sales tax collection allowance. This Act was codified as § 10-45-27.2. The vendor compensation program allows any person who files a sales tax return on a monthly basis to receive a credit of one and one-half percent of the gross amount of sales tax due. However, the credit may not exceed seventy dollars per month.

The effective date of the vendor compensation program was tied to another piece of legislation also enacted during 2006 legislative session, which created a Tax Relief Fund pursuant to the provisions of HB 1167. The Legislature dedicated the revenue to the Tax Relief Fund from sales and use taxes collected and remitted by voluntary retail licensees registered with the state through Streamlined Sales and Use Tax Agreement. When the cumulative balance of the money deposited in the Tax Relief Fund reaches ten million dollars, the vendor compensation program established in § 10-45-27.2 becomes effective on the following July first.

History of the Sales Tax Collection Allowance or Vendor Compensation

The sales tax collection allowance or vendor compensation originated in the 1930s in several states to offset the administration costs associated with sales tax collections and remittances when records were kept by hand and businesses were primary cash and carry. Today there are more sophisticated methods to keep those records, file reports, and remit the money to the state. However, vendor compensation continues to be provided in 26 states. In part, this is due to a strong lobbying effort on behalf of the retailers in some of these states despite state governments experiencing fiscal distress and looking for means to enhance state revenues.

On the other hand, the sales tax rate on goods and services is levied at a higher rate and the tax is applied more broadly then it was in 1930's. Back in the 1930's the initial sales tax rate for South Dakota was established at 2%, raised to 3% in 1965 and 4% in 1969. There have been periods where that sales tax was temporarily increased by a percentage point for railroads and economic development in the 1980's. The sales tax was also increased by a percentage point in 1937 to provide funding for elderly, welfare, children and other programs. This tax increase was rescinded in 1943.

If the sales tax rate or the use of credit cards at retail establishments increases, the administrative costs to the retailer for collecting the sales tax increases as well because of credit card transaction fees and other overhead costs.

Numerous retail transactions are completed with credit cards, and the retailers are subject to credit card fees on the entire amount of the transaction including the tax collected on behalf of the state.

If a retailer accepts credit cards, the business faces a number of credit card fees and expenses, with the primary expense being the discount rate, which is usually 1% to 3.5%. Other credit card fees include transaction, chargeback, monthly statement, address verification, startup, termination, equipment, and annual fees.

History of Sales Tax Collection Allowance in South Dakota

The South Dakota sales tax collection allowance was originally enacted by section 3 of SB 254 which was passed during the 1990 session. Retailers were allowed to retain one and one-half percent of the gross amount of tax due or seventy dollars per month, whichever amount is less. It was codified as § 10-45-28.1, which was repealed by HB 1352 in 1995. The collection allowance was repealed as part of the Governor Janklow's 1995 proposal to provide property tax relief. The repeal of the collection allowance was projected to provide $2.6 million towards property tax relief in 1995. This repeal was packaged with several other initiatives including the repeal of the personal property tax replacement funding, budget cuts, eliminating certain sales tax exemptions, increasing the tobacco tax, and increasing the state's share of video lottery revenues.

The Policy of Other States on Vendor Compensation Allowance

Currently twenty-six states allow vendor compensation or sales tax collection allowances for retailers acting as tax collectors on behalf of the states. Nineteen states do not allow for vendor compensation or collection allowances and five states do not have a state sales tax. There are thirteen states that do not have any limit on the amount a retailer may receive as vendor compensation. A few of the larger states annually lose $75 to $125 million of revenue for their vendor compensation program.

However, the South Dakota legislation found in § 10-45-27.2 provides a ceiling of seventy dollars per month which is eight hundred forty dollars per year for the vendor compensation allowance for any person required to file a monthly return. South Dakota has, once it becomes effective, one of the more restrictive vendor compensation ceilings of the states that have established maximum vendor compensation allowances. North Dakota allows a maximum of eighty-five dollars per month and Nebraska allows seventy-five dollars per month. Minnesota, Iowa, and Wyoming do not offer vendor compensation allowances to retailers.

Other Tax Collections

Retailers are not reimbursed for collection of payroll taxes, social security, unemployment insurance, workers compensation, or other forms state or federal mandates. It is a cost of doing business. Therefore policy makers may find a number of instances where the state or federal government does not reimburse businesses or individuals for the payment, collection, or remittance of taxes.

On the other hand, the state charges municipalities an administration expense to defray the cost of collecting the municipal sales and use tax on their behalf.

Effective Date and Revenue Impact

Based on revenue estimates for the tax relief fund, it appears that the compensation allowance will become effective on July 1, 2014. At that point in time it appears there will be about $1.5 to $2 million of revenue annually deposited in the Tax Relief Fund. However, the purpose of the Tax Relief Fund is to reduce the rate of taxation or to lower property taxes. The Tax Relief Fund was not intended to offset the cost of the vendor compensation allowance to the general fund.

Tax Relief Fund Deposits	
FY 2007	$883,065
FY 2008	$1,364,287
FY 2009	$1,241,059
FY 2010	$1,275,169
FY 2011	$1,524,369
FY 2012	$1,658,864
Total	**$7,946,813**

Once the vendor compensation allowance legislation (§ 10-45-27.2) becomes effective, the state general fund revenues are estimated to be reduced by approximately $5 to $6 million per year.

Streamlined Sales Tax System Collection Allowance

Under the provisions of the Streamlined Sale Tax Agreement, the entity collecting and remitting the taxes to the states will receive a collection allowance. Currently, there are six third party providers certified by Streamlined Sale Tax Project.

The third party providers accepts certain risks if they make a mistake in their software, as they have to make sure the correct tax is applied to each sale. The retailer is not liable for the incorrect application of the tax and the state is only liable if they provided incorrect information to the third party provider.

The third party provider does receive compensation for the role provided in the process. The rate of compensation ranges from 8% of the tax collected to 2% based on a sliding scale.

The state is expected to provide reasonable compensation to retailers for their sale tax collections as part of the Agreement.

Conclusion

The vendor compensation or sales tax collection allowance is permitted in about half the states that have a sales and use tax. If a state does permit such compensation, there are economic and budget reasons for the state to establish a maximum amount either on a monthly or annual basis to be received by each retailer. Otherwise, the compensation paid to certain large retailers could become a budget bleeder. South Dakota has established a maximum vendor compensation allowance which is one of the lowest in nation.

The South Dakota vendor compensation allowance will most likely become effective for State Fiscal Year 2015. However, if revenues deposited in the Tax Relief Fund increase faster than projected and the ten million dollar revenue threshold in the Tax Relief Fund is unexpectedly reached in June 2013, then the legislation becomes effective on July 1, 2013. This would occur after the FY 2014 budget had been set. In addition, it may be somewhat difficult to implement the vendor compensation allowance by July 2013, if this threshold is unexpectedly reach in the last month. This may also provide certain implications on the FY 2014, which may suddenly be impacted by a $5 to $6 million dollar decrease in revenue. However, based on current projections that event is not expected to occur at that time.

This issue memorandum was written by Fred Baatz, Principal Research Analyst for the Legislative Research Council. It is designed to supply background information on the subject and is not a policy statement made by the Legislative Research Council.
