Proposal for a Prospective-Only Voluntary Disclosure Program

Presented to the

Multistate Tax Commission

Nexus Committee

Janette M. Lohman
Partner
Thompson Coburn LLP
One US Bank Plaza, Suite 3500
St. Louis, Missouri 63101
P (314) 552-6161
M (314) 602-6161
jlohman@thompsoncoburn.com

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I. Introduction

Thank you for this opportunity to present this request for your consideration!

A. Who I am. I am a former Director of Revenue from Missouri (1993 – 1997), and a former member of the Multistate Tax Commission’s (“MTC”) Executive Committee (Treasurer 1997). I am currently a law partner in the St. Louis Office of Thompson Coburn LLP. Neither my firm nor any of my clients is paying for the cost of either drafting this presentation or my travel expenses and time making this trip.

B. Why I am here. I come to you, as a former colleague and friend, with a request for the MTC to consider offering the same type of “short-term” (or longer) “prospective only” voluntary disclosure program that Missouri’s Department of Revenue (“DOR”) implemented on a full-time basis, during my tenure as Director.

C. Why the program is necessary. A few years ago, one of my clients, an information technology (“IT”) professional (actually, a Millennial IT genius), created and implemented a sophisticated Internet start-up business (the “Business”). The Business began slowly, but now, appears to be growing exponentially. The Business is not located in Missouri, but its entire operations are contained within one state. The Business has no offices or other
facilities outside of its home State and none of its employees travels to any other State for business purposes. The Business neither owns nor leases tangible personal property in any other state. It is questionable whether the Business actually has “click-through” nexus under the definitions provided by any of the twenty (20) or so existing “click-through” statutes or regulations. It is web-based, but there are so many overlays, interconnections, and aggregations of other vendors’ websites’ goods and services, that it is difficult to accurately describe it. The Business does not sell its own products, and maintains no inventories for resale anywhere. As the Business’ counsel, I cannot validly advise the Business that it is clearly required to register under any of the existing click-through statutes (including available guidance and regulations), save Iowa’s new statute, but only because I have not yet reviewed it (my apologies).

1. During the past two years, two States have approached the Business with questionnaires, and the Business has responded to them honestly. We have heard nothing back from either State, other than having one or two follow-up requests for additional explanations of the Business (to which the Business has responded) that are now rather dated.

   a. The Business is, in fact, properly registered and compliant with the tax laws in its own state. The Business’ owner does not believe that it should be taxable in any State other than the State in which it is based, but if ever challenged, the Business must overcome the presumption and prove that it is not “represented” in click-through states. The Business is also concerned about just coming forward to registering in any other State, because its competitors are not registered, and registration will put the Business at a competitive disadvantage.

   b. Nonetheless, the Business would gladly and voluntarily start collecting and remitting state use taxes in the “click-through” states on a prospective basis, if that by so doing, those States (i) would not immediately label such actions as admissions of “substantial nexus” and soon after, (ii) audit the Business for potentially the shorter of all prior periods or the relevant statutes’ inception. If this were to happen, there is a threat of bankruptcy, either from crippling “look-back” taxes, interest, and penalties, and/or paying expensive legal and accounting fees necessary to fight approximate twenty (20) different legal battles, all located in other states.
c. The Business did retain me to file requests for “prospective only” voluntary disclosure agreements ("VDAs") with the MTC for click-through States who participate in the MTC’s National Nexus Program (“NNP”). When I contacted Mr. Richard Cram, the NNP’s Executive Director, prior to commencing the process, Mr. Cram advised me that one other similarly situated Taxpayer had already approached the NNP with the same request, and had been rejected. Mr. Cram told me that the States’ lack of interest was based on the rationale that if a Taxpayer does not have substantial nexus, it does not qualify for the VDA program. If a Taxpayer does have substantial nexus, it should come forward through the normal VDA program, and pay the look-back taxes and applicable interest like all other Taxpayers.

2. My response is, why wouldn’t the MTC, or all States, for that matter, let Taxpayers with questionable nexus come forward on a prospective basis? For the record, I wanted to share with you my own past experience when I was Missouri’s Director, as described in the following paragraphs.

a. Missouri’s Experiment. Back in 1994 (just two years after the Quill\(^1\) decision was handed down), Missouri was in a dire financial situation because our sales and other tax revenues had dramatically declined due to substantial flooding in the prior year. The DOR’s Director of the Division of Taxation, Robert Schemenauer, approached our General Counsel and me with the idea of turning a Discovery Unit policy into an open-ended VDA policy. Under that policy, we permitted “discovered” Taxpayers with “arguably no or very little actual physical presence in Missouri” to enter into settlement agreements with the DOR, under which the DOR would agree to concede the substantial nexus issue for all prior periods in exchange for the Taxpayer’s agreement to register for use tax collection purposes prospectively, thereby conceding the substantial nexus issue for the lesser of five (5) years (i.e., Missouri’s then normal look-back period for “discovered non-filers”) or the Taxpayer’s cessation of business. So, why not give all taxpayers with “questionable physical presence in Missouri” the right to come forward without retribution?


i. From the DOR’s standpoint, we believed that actually getting non-compliant taxpayers on the tax rolls was the most important goal – the DOR was as much to blame as the Taxpayers were for our not properly educating both vendors and consumers about their responsibilities under the use tax laws. Our excuse for this lack of education was that we didn’t have sufficient resources for enforcement, let alone positive outreach. We could not afford to assign any more employees to the DOR’s Discovery Unit, and could not obtain appropriations from the General Assembly for more “FTE” (for any purpose).

ii. Also, we believed that it was presumptuous for us to even think that all Taxpayers, particularly start-up businesses, had unlimited recourses from which they could draw to develop computer systems that could calculate and collect our State’s taxes.

iii. Director Schemenauer convinced our Senior Staff and me that it was in the State’s best interests to let all Internet, mail-order, or other vendors who came forward voluntarily, to do so prospectively, but only if their only actual physical contacts with Missouri consisted of “minor snippets” in prior years. Under our policy, “caught” out-of-state vendors with undeniable “substantial nexus” (i.e., those with offices, employees, and/or material levels of property permanently located in Missouri) were required to collect the tax, and would not be given “prospective only” relief. From an administrative standpoint, however, finding and registering “offenders” was a long, difficult, and expensive process, with comparatively poor revenue producing results because:

(a) We had to identify them.

(b) We had to send them our massive nexus questionnaire.

(c) We had to follow-up with additional requests, and sometimes had to drop the “case” altogether after repeated requests.

(d) If they responded positively to any one of the multiple questions on the voluminous questionnaire, we would have to send our auditors to the
out-of-state location to perform the audit for a five (5) year period, make the assessments, and begin the collection/appeals process. Accordingly, the DOR’s Discovery Unit would enter into “prospective only” settlement agreements when (i) the DOR’s “substantial nexus” case was “weak” and (ii) the Taxpayers agreed to forgo raising the “no substantial nexus” issue for an agreed to number of future years. As I recall, most of our Discovery Unit’s increased revenue collections resulted from these settlements.

c. Consumers Use Tax Enforcement (or Lack Thereof). At the time, the DOR had recently tried and failed to enforce the consumers use tax. Prior to the 1994 filing season and immediately post *Quill*, the (then) Executive Director of the MTC encouraged all of its Member States to enforce the consumer’s use tax by including the use tax forms with the individual tax forms. **I was “new” to my role, and politically clueless enough to implement this.** As a result:

i. I personally received several anonymous death threats.

ii. The Missouri General Assembly and the Governor received numerous questions and complaints about the “new” tax from their constituents and started to make serious trouble for the DOR and me personally.

iii. The Governor renounced me publically as being an “overzealous bureaucrat” even though he had authorized our actions, and I had to admit that the Governor had been pre-briefed about our actions in testimony before the Missouri Senate Ways and Means Committee. (The Committee and the press were stunned in to silence by my honesty, but no one printed a word against either the Governor or me for trying to enforce Missouri’s laws. They just didn’t want us to enforce the use tax laws **against Missouri’s voters**….)

iv. The General Assembly immediately passed an Act that delayed the consumers use tax **filing** requirement until a Taxpayer’s annual sales reached $2,000.00, thus nullifying most of my actions and placating the voting public.

v. Miraculously, I managed to keep my position for several more years.
d. **Legal Authorization.** Our General Counsel advised the Senior Staff that, as Director, I had the power to enter into settlement agreements with any Taxpayer to waive the DOR’s prior years’ nexus arguments in exchange for prospective compliance under hazards of litigation. We were already doing that in practice, anyway, for “caught offenders” and it was actually **bad** policy to treat voluntary disclosure candidates worse than “caught offenders”.

e. **Final Decision.** Under the circumstances, we concluded that it made no sense to spend more of the DOR’s valuable time and resources (that we did not have to spare anyway) looking for more “offenders” (either vendors or consumers), when there were probably numerous vendors who had “tiny bits of nexus” and whom we would probably never catch anyway, but who likely would come forward voluntarily on a prospective basis if we just gave them the chance. Accordingly, the DOR’s Senior Staff voted unanimously to convert our “silent” practice into a public policy, and advertised this new policy to see what would happen.

f. **Implementation and Results.** We set reasonable parameters and posted this notice on our website and included it in our public newsletters. We announced it at all of our public presentations and appearances in other states, and otherwise, did everything we could to get the word out to the non-Missouri public. In the first year of our program, I recall that we dramatically increased the proceeds collected by our “Discovery Unit”, which consisted of only forty (40) DOR employees. One “new” vendor alone collected and remitted over $900,000.00 in the first year of our program, and our “Nexus Waiver” policy won a “Missouri Governor’s Award for Quality and Productivity” at the State Level. That was almost a quarter of a century ago. Although I do not know what the current DOR policy is. I do know that (i) the DOR continued to maintain this policy throughout my tenure in office, and (ii) the program consistently added **substantial additional revenues** to our Treasury without the DOR having to spend a cent searching for it.
II. Request for Proposal – Prospective Voluntary Disclosure Program - Proposed Terms and Conditions.

A. Prospective only (no look-back period taxes, interest, or penalties).

B. Only applies to direct mail, Internet, and other vendors who have no obvious or material actual physical presence in the State. Taxpayers would certify to all of the following facts under penalties of perjury:

1. They have no actual offices, warehouses, or other tangible facilities located in the state.

2. They have no permanent or part-time employees located in the State.

3. They have no permanent or part-time salesmen located outside the state, but assigned to the state as a sales territory. (Random attendance at trade shows or sporadic, unassigned visits of more than ten (10) visits per year would bar participation.)

4. They have no “material” inventory or other tangible personal property owned or leased in the State. (Merely owning or leasing servers in the state would not count. Also, I would advocate letting in the large percentage of “Amazon FBA-types” who missed their limited opportunity last year. These vendors have no control over where their goods are stored, which goods are shipped out of which warehouses, how much of their goods are stored in each warehouse, etc.)

5. Each Taxpayer must have sales in the State equal to or in excess of $25,000 per quarter for the past 36 or fewer quarters in at least one or more states. (Most new businesses will generally start “small” and (hopefully) grow. Although small applications could be a nuisance for the MTC and States to administer, small applications multiplied by numerous States equals “not so small dollars” to a start-up Taxpayer. That is, if the Taxpayer must come forward in twenty (20) States, the fact that the
Taxpayer only has de minimus sales in several of them should not disqualify the Taxpayer from entering the program.)

6. Each Taxpayer must not be under formal notice of audit from the relevant DOR or “beyond” (i.e., must not be currently in audit, appeals or litigation over a “nexus-related” or other issue with the State). (Merely having received a nexus questionnaire from the State about which the State has not yet issued a notice of audit or assessment within the past five (5) years should not bar participation.)

C. The State must agree to waive any arguments that the Taxpayer had substantial nexus for all prior periods, absent actual knowledge by the State that a Taxpayer has committed fraud in completing the certification.

D. Each Taxpayer must agree to continue to collect and remit use taxes, regardless of whether the Taxpayer has substantial nexus, for the lesser of ten (10) years, or cessation of having State customers, regardless of subsequent law changes.

E. If I were standing in your shoes, I would obviously make this a permanent program. Otherwise, I would suggest setting a minimum of a six (6) month time period, particularly for Taxpayers to bring their use tax collection systems into compliance. States should realize that decision-making at the highest levels of even small businesses takes time, and compliance requires major (and sometimes expensive) software updates in order to get new collection systems established, particularly when numerous States, and even numerous rates within a single State, are involved.
III. Additional reasons why the MTC and Other States Should Consider Offering this or a Similar Prospective-only VDA.

A. Ensure Future Compliance. This suggestion is intended for prospective use-tax collection responsibilities, but should also be extended to all tax types collected by the participating States, if applicable. For those States imposing taxes on net income or gross receipts, the collections from the other tax-types would probably not be as substantial, though, depending upon the facts and circumstances of the particular Taxpayer and the particular State. Also, unlike “amnesty programs” that tend to accelerate audit collections, voluntary compliance programs bring “new” use tax revenues to the States.

B. Avoid Costly Litigation. The targets of this proposed VDA program are Taxpayers who would have strong enough facts to legitimately litigate the issue of whether they had “substantial nexus” with the State if they were ever questioned. In light of the pending Wayfair case, I believe that there are many Taxpayers who are, like the Business, afraid to come forward, for fear of being audited (and potentially being bankrupted through either payment of legal fees or look-back assessments) for prior periods. A Taxpayer who comes forward under this program would make what happens in Wayfair moot with respect to its situation for both the Taxpayer and the States.

C. Presumptive Nexus is Not “Direct” Actual Physical Presence. Taxpayers with nexus stemming from “attribution only” should be permitted to come forward to voluntarily register to collect and remit State use taxes, without fear of audit or retaliation (absent fraud) for prior periods.

1. Although “click-through” nexus and “affiliate” nexus statutes have been contested by taxpayers and litigated by some states, such nexus is created only by “presumptive” statutes, and none of these “representative nexus” statutes has yet to be reviewed by the Supreme Court of the United States.

2. Coming forward voluntarily to collect the use taxes when it is has not been finally determined that a Taxpayer has an actual physical presence in a State will put

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2 South Dakota v. Wayfair, Inc. et al., S.D. S. Ct., 2017 SD 56 (2017), cert. granted, U.S. S.Ct., Dkt. No. 17-494, 01/12/2018
these willing Taxpayers at a competitive disadvantage with other similarly situated businesses who chose not to come forward. Even so, I believe many of these Taxpayers will do so anyway, out of fear that the Wayfair decision could eliminate the actual physical presence standard set for “substantial nexus”. If the States offer even a “short-term” (i.e., six (6) month) prospective-only VDA that commences prior to the Wayfair hand-down date, many such Taxpayers will likely register and start collecting anyway just to avoid potentially costly, and time consuming litigation over the issue (either way). **What may or may not happen in Wayfair should not affect whether the MTC Nexus Committee States and other States offer this program.**

D. **Substantially Increase Revenue Collection More Efficiently.** While everyone waits for Wayfair to be decided, States are losing potentially millions in revenues that these Taxpayers would be collecting now, if those Taxpayers knew that such voluntary collection would not be deemed to be an admission that they did, in fact have substantial nexus with the State, particularly for all prior periods.

E. **Assistance with Revenue Collection.**

1. Because these Taxpayers have “tenuous, most likely insubstantial” nexus anyway, they are still, despite improved technology, difficult for States to find, and the audit, appeals, and litigation processes are costly, time consuming, and result in lost revenues that the States are unable to enforce against the Taxpayers’ customers.

2. Has your State been successful in enforcing your State’s consumers use tax?

3. Do you really believe that “reporting” or “rat-out” statutes that States are starting to enact (after Colorado recently “won” that round), will be effective?

   a. Compliance with such statutes appears to be an administratively burdensome nightmare from both sides, and does not appear to be a satisfactory solution to the problem. The out-of-state, no-nexus Taxpayers who are not compliant with these statutes will be

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difficult to find in the first place, and States have limited resources with which to search for them.

b. Do any of MTC’s Member States have staff and other resources sufficient to track down all of those out-of-state vendors who are not compliant with their new reporting-only statutes?

c. Even for States who are equipped to handle this process, do these States have staff and resources sufficient to track down all of their in-state consumers who owe these consumers use taxes once they’ve received the voluminous lists of relatively tiny transactions from the out-of-state vendors?

d. Do you really think that those in-state consumers in YOUR State will NOT complain to their State Senators, State Representatives, and even the Governor when you try to collect these snippets of lost revenue from “new” taxes?

F. If Quill is upheld, nothing will change. Even if the Wayfair decision upholds Quill’s “actual physical presence” requirement, neither click-through, market-place, affiliate, nor Amazon-FBA nexus issues are likely to be addressed therein, because only a statute with “no actual physical presence required” is before the Court. If Quill is upheld, these issues will remain, and will have to be litigated…, and litigated…, and litigated…, on a State-by-State basis, until ripe cases finally reach the Supreme Court of the United States. Do you have the patience to wait another twenty-five (25) years for the answers?

G. Save our Entrepreneurs! Total enforcement of “click-through” and/or “market place” against the IT entrepreneurs, like the Business, could wipe them out completely. The Business is but one example of the thousands of start-up businesses that are surfacing throughout the United States, compliments of an entire generation of IT wizards. Wouldn’t it be better to just give them all a chance to register and collect, and have the State’s Treasuries reap the bounty of their genius? Isn’t it the right thing to do?
IV. Closing Remarks.

The Business does not trust that the MTC, its NNP Members, or any other State will take my proposal seriously, and thus, the Business was unwilling to pay me for this (seemingly futile) fool’s errand to bring this alternative to your attention and make my case. I feel strongly about this being a true “win-win” for both sides, including all “already compliant” vendors who, along with each State’s residents and businesses, are bearing the costs of compliance (or non-compliance), one way or another. Besides, when my DOR tried it twenty-five (25) years ago, it eliminated my receipt of personal “death threats” for “doing my job” and produced a Governor’s Award for increased revenue collections. As a sanity check, I asked several of my current and your former colleagues to review this presentation, and the following members of the “Informal Former Revenue Commissioners Club” all voiced their enthusiastic support for all States to implement this or a similar proposal and permitted their names to be added:

- Burnett R. Maybank, III (former Commissioner from South Carolina);
- Thomas M. Zaino, (former Commissioner of Revenue from Ohio);
- June Haas Summers, (former Commissioner of Revenue from Michigan and former Director of the MTC Nexus Program); and last but not least,
- Joe Huddleston, former Commissioner of Revenue from Tennessee and former Executive Director of the MTC, who felt so strongly about this proposal that he is here with me now, and will address you when I (finally) release the podium.

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Thank you again for your time and attention. I truly believe that implementation of this request or its equivalent would make your Directors and Commissioners heroes, because I believe this proposal is practical, fair, and is in the best interests of fair tax administration. It is a cost effective, politically correct, and revenue producing alternative. I believe that it is the right thing for you all to do. And I sincerely hope that you agree!