MULTISTATE TAX COMMISSION

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Minutes

Income & Franchise Tax Subcommittee Teleconference Meeting
Sales and Use Tax Subcommittee Teleconference Meeting

Thursday, September 30, 2010
11:00am to 12:30pm Eastern

States	Industry	MTC Staff
Wood Miller, MO, Uniformity Committee Chair	Dan Shibley, CCH	Shirley Sicilian
Richard Cram, KS, Sales and Use Tax Subcommittee Chair	Todd Lard, COST	Roxanne Bland
Robynn Wilson, AK, Income and Franchise Tax Subcommittee Chair	Fred Nicely, COST	Bruce Fort
Rob Carter, KY	Jennifer Jensen, PWC	
Michael Fatale, MA	Karen Nakamura, PWC	
Stuart Binke, MI		
Brenda Gilmer, MT		
Louie Gomez, NM		
Myles Vosberg, ND		
Gary Humphrey, OR		
Janielle Lipscomb, OR		
Bruce Christensen, SD		
Lili Crane, WI		

I. Welcome and Introductions

Wood Miller, Uniformity Committee Chair, welcomed the participants to the meeting.

II. Public Comment

There was no public comment at this time.

III. Projects

A. Project for Use Tax Notice and Reporting Statute

Richard Cram, Sales and Use Tax Subcommittee Chair, said this project began in response to the statute and regulations enacted by CO last spring, requiring sellers shipping products into the state to provide clear notice on their sales documents that, if the seller is not collecting sales or use tax, the purchaser may be liable for tax, and to provide an annual report to both the purchaser and the Department of Revenue summarizing information on consumer purchases.

1. Staff Summary

Shirley Sicilian, MTC General Counsel, summarized the draft model. She reminded the group that this is not a tax statute, but a reporting statute. The model has five sections. The first section, concerns administrative provisions, and identifies the department of revenue as the agency responsible for administering and enforcing the Act. Section B covers definitions. Section C is the meat of the model statute, containing the notice and reporting requirements for remote sellers. The drafting group's suggested amendments are intended to make clear that the Act applies to persons who are or would be subject collection responsibilities if they had nexus in the state. The drafting group also suggests removing the language that describes the taxable event because different states have different taxable events. Whether a sale or use is subject to the reporting act is a function of whether it is or would be subject to taxation under the state's sales or use tax act. Persons who make sales or leases into the state and do not collect tax are required to provide notice to the purchaser, in the time and manner required by the Act, and subject to penalty if there is a failure to do so. The section also covers requirements to provide an annual report to the purchaser, when that report is due and penalties for failure to make a report. A seller who falls within the act's requirements is also required to file an annual report with the department, and the Act establishes penalties for failure to do so. Section D contains two exceptions for small sellers, and Section E concerns confidentiality—all information received by the state shall be treated as confidential, and all penalties and remedies apply.

2. Public Comment

There was no public comment at this time.

3. Committee Discussion

Mr. Cram said that his objective is to make sure the subcommittee is comfortable with the changes to the draft, second, if anyone has suggestions for improvement, to bring them up for discussion. In the interest of time, unless members of the subcommittee express interest or concern, he will assume the subcommittee is comfortable with the changes to the draft. He asked if the subcommittee had comments on the introduction to section (c). He asked if there was a possibility that use of the term "subject to tax" will pick up exempt items. Bruce Fort, MTC Counsel, volunteered that "taxable under the act" would be an alternative. Michael Fatale, MA, said he thought "subject to tax" was probably the right phrase. Ms. Sicilian explained that courts have interpreted "subject to tax" to exclude exempt items because "subject to tax" includes only those items that are actually taxed, rather than all those items that are "taxable," so "subject to tax" may be the right phrase, but the drafting group can address this in more detail later.

Myles Vosberg, ND, asked wasn't the objective that the seller would not have to know what's taxable or not. Ms. Sicilian said yes. The seller is required to provide notice and report on sales into the state for which tax is not collected, but they would not be subject to penalties for failure to notice or report on exempt sales. The notice required indicates that the buyer "may" be required to remit tax directly to the department. The seller does not have to know whether the buyer is or is not required to remit any tax to the department. Mr. Vosberg then asked if the seller sells taxed and exempt property does it have to report the sales that are subject to tax. Ms. Sicilian said the seller is required to notice and report. If it doesn't report, it will be subject to penalty for failure to report those sales that were subject to tax. If some sales are not subject to tax, the seller would not be subject to penalty for failure to notice or report on those. Mr. Cram said that he thought this is probably the best approach. The introductory paragraph is as broad as possible. Other members of the Subcommittee indicated agreement.

Mr. Cram then addressed section (c)(1), which describes the notice requirements to purchasers. He suggested that the notice requirement should be shown on the invoice as well as receipts, etc. He also noted that in (c)(1)(B)(ii), a seller does not have to indicate to the purchaser if the transaction may be exempt and this raises the question of whether the draft should it be left that way or should it get into details. He said perhaps that is more appropriate for a regulation. Another question raised is whether this subsection puts an obligation on the seller to know whether the transaction is exempt or not—e.g., if the purchaser given an exemption certificate—or would the seller know because the product is exempt, like prescription drugs. Mr. Fatale said too much detail is not a good idea for the Statute. Ms. Sicilian added that it might not be usual to present an exemption certificate when the seller isn't attempting to collect the tax. The certificate might be more likely to be presented to the Department if the Department follows up on the report.

Mr. Cram described subsection (C), the penalties section. The section prescribes $X in penalties per failure to provide notice, with limits on how much can be assessed in a calendar year. Penalties can be limited if a seller without actual knowledge of the statute begins providing notices within 60 days once it receives actual knowledge (C)(i), and penalties of $Z if the seller had actual knowledge or did not provide notices after receiving actual knowledge, (C)(ii). The Director can waive penalties for good cause shown. Mr. Cram asked whether there is an issue with proving actual knowledge. Ms. Sicilian noted that this language is from the CO statute. Mr. Fatale said that it could raise difficult questions as to who in the organization might have actual knowledge; an issue of reasonable cause. Mr. Vosberg said actual knowledge can be a consideration of waiving penalties. Mr. Fatale agreed. Several members of the Subcommittee indicated agreement that this language on actual knowledge should be removed.

Mr. Cram suggested that perhaps (C)(i) and (C)(ii) could be collapsed into one provision. Mr. Fatale said that might be better. Mr. Cram asked if anyone had any thoughts about the amount of penalties. CO uses $5 with a calendar limit of $5,000. Perhaps this is something that shouldn't be specified and leave it up to the state. Mr. Fatale said this is a harder question because we don't know what penalty amount would bring about correct behavior in different circumstances. Mr. Miller suggested that leaving the penalty amounts at "x" allows states to insert a number appropriate to their circumstances. He added that not knowing where this act would appear, whether a phrase was needed that the collection of penalty is pursuant to the existing sales and use tax act, or is it anticipated that the act will be adopted into the existing sales and use tax act. Ms. Sicilian responded that the Subcommittee, during prior discussion, determined that it should be a stand-alone Act. Mr. Miller then asked if a penalty is imposed, is the seller served by certified mail, and do they have appeal rights. If they don't pay, does the state have recourse. These questions could be addressed in section (a). Ms. Sicilian said that subsection (a) can be fleshed out to explicitly address protest periods, administrative procedures, and the finality of penalty assessments that are not timely protested.

Mr. Cram then turned to section (c)(2)(A), Annual Report to Purchaser. He asked if there were any comments or concerns that if the seller knows the transaction is exempt, does it have to list the transactions on the report or does the seller list both exempt and non-exempt transactions. The assumption is that the seller does not know the transaction is exempt and the purchaser may be required to know. Mr. Fatale said that is consistent with the idea that we don't want to make the seller determine exempt or non-exempt transactions. Others on the Subcommittee agreed.

Mr. Cram noted that in (c)(2)(B), a cost is imposed on sellers to send the notice out to purchasers. He asked whether the statute should retain the paper requirement or should it be an option for the seller. Mr. Fatale said to send electronically reduces the chances of someone reviewing it. Mr. Cram said that his comments made with respect to (c)(1)(C) also apply to (c)(2)(C), i.e., collapsing (C)(i) and (C)(ii), the actual knowledge requirement, etc.

Mr. Cram pointed out that Colorado does have a $500 de minimis for purchasers. The current draft does not have a de minimis. He said he wasn't certain if a de minimis was necessary, but asked whether anyone had a concern. He commented that the de minimis threshold might be something each state wants to think about for themselves, but that it is a good concept. He suggested that the workgroup add de minimis placeholder language. Ms. Sicilian noted that the CO rule does have a de minimus for purchasers, but that the sellers have commented in CO that it is actually easier for them to just report it all, rather than have to split out a de minimus category for non-reporting.

Regarding section (c)(3)(B)(i) and (ii) (penalties), the drafting group will make the same changes as above. Mr. Vosberg asked concerning the penalty per failure to file, will there be a provision to allow the state to estimate the number of failures. Mr. Cram said that was a good suggestion, and if Mr. Vosberg has any ideas on language, it would be appreciated.

Mr. Cram then turned to section (d), the small seller and de minimis in-state sales. The amounts were left blank; he said he did not know if the subcommittee was in a position to talk about amounts. He also said that a small seller is one whose gross sales are under a threshold amount everywhere, and a de minimis seller is one whose sales are below a de minimis threshold in the state.

There were no additional comments on the amendments to (e), confidentiality.

B. Project for Review of Tax Haven Provision in MTC Model Combined Reporting Statute

Robyn Wilson, Income and Franchise Tax Subcommittee Chair, opened this topic and asked Bruce Fort, MTC Counsel, to provide a summary introduction.

Mr. Fort summarized the PowerPoint and memorandum previously distributed at the July meeting. The MTC model combined reporting statute water's edge election provisions provide for inclusion of some non-domestic entities in the combined return, including the income of entities doing business in "tax havens" in some circumstances. Mr. Fort said that the model statute's current definition of tax haven has two separate tests. The first test is whether the jurisdiction has been identified as a "tax haven" or regime with a harmful tax practices in the current year by the OECD. The second test is whether the jurisdiction has no or nominal tax rates on the "relevant income" and exhibits one of six criteria suggesting the jurisdiction encourages tax sheltering. Mr. Fort indicated the first test is now out of date because the OECD no longer identifies tax havens or jurisdictions with "harmful tax practices" on an annual basis. The OECD has instead adopted an "internationally-agreed tax standard" which calls for information sharing agreements among some OECD countries. The second set of criteria, while constituting a good definition of what might constitute a tax haven, suffers from being subjective in nature and therefore difficult to administer in self-reporting tax systems.

Because the OECD no longer provides an annual list of tax havens or jurisdictions with “harmful tax practices”, the IFT Uniformity subcommittee has undertaken a project to amend or eliminate the current model’s tax haven definition. Mr. Fort suggested a possible solution to defining tax havens in an objective manner might be by reference to the host country’s tax rates alone. Ms. Wilson pointed out that using tax rates alone is the approach used by AK. Mr. Fort noted that using tax rates alone eliminates the need to label particular jurisdictions as tax havens. Mr. Fort continued that another possible solution would be to use the current subjective criteria but have a list of tax havens maintained annually by the MTC or a state. Or, the states could use a list from other sources like the GAO; CA is considering a definition of tax haven that would include all countries listed by three different organizations. Alternatively, the definition of tax haven could be abandoned entirely, leaving the states to rely on the other categories of includable jurisdictions (including any entity subject to Subpart F income standards), and relying on the federal government to do a better job of policing international transactions.

Todd Lard, Council on State Taxation (COST) said that COST has commented on this provision when it was developed as part of the combined reporting project. He said COST will pull back to see how the effort develops, but the committee made a number of practical and policy decisions that COST felt could raise foreign commerce clause concerns. But the committee was comfortable because this is essentially a world wide combined reporting statute with an election for water’s edge, so the foreign commerce clause is not implicated. Also, because the OECD is an organization of which the U.S. was a member, the implication was that the U.S. condones identification of tax havens consistent with OECD standards. But States all treat foreign entities and income differently, which may raise Foreign Commerce Clause concerns if the OECD is no longer used for guidance.

Mr. Fatale asked Ms. Wilson how well the provisions in the AK statute work. Ms. Wilson said the state hasn’t had much experience with it as most of their experience is with taxpayers on world wide combined reporting. There are other questions to ask before reaching water’s edge. Mr. Fort said that by having reference to an effective tax rate, there is more certainty and it encourages voluntary tax compliance. It also takes care of states interjecting themselves into foreign tax policy disputes. The GAO reported that most income shifting occurs in multiple transactions in multiple countries, which may call for a more complex approach to the problem of tax losses on international transactions. A combination of low tax rates and case by case examination of transactional activities by the taxpayer’s affiliates, direct or indirect, would be very effective and get the states out of the business of naming tax havens. Ms. Wilson said having subjective criteria invites controversy, and she’d rather have a bright line. She also said that AK excludes payments for intangibles, and if the subcommittee chooses to pursue this line of inquiry, it would be appropriate to talk about it.

Ms. Wilson then asked about other states’ experiences. Mr. Fatale said his state did not adopt the MTC tax haven provision. He noted that MA did adopt the MTC

20% affiliate transaction rule, though. There has been much concern expressed by the taxpayer community. Massachusetts adopted regulations to go with the 20% provision that specify in detail how to determine the 20%, what transactions count, etc.

Brenda Gilmer, MT said that her state has a list of tax haven countries in statute. The list is derived in large part from the original OECD list. It is revisited every two years and the department makes recommendations to the legislature regarding which countries to take off the list, and which to put on. They look to OECD information in making their recommendations. She also said that as there is more federal focus on offshore financial transactions, it becomes easier because then they can identify the countries that are tax havens.

Mr. Fort asked the subcommittee how it would like to proceed. Ms. Gilmer suggested taking a look at the AK method. Ms. Sicilian suggested looking at MT's approach also. Mr. Miller said he liked both ideas and the group should review them as the first consideration out of the five possibilities for amendment outlined in the PowerPoint presentation and that the subcommittee would revisit the issue in December.

IV. New Business

There was no new business.

V. Adjournment

The meeting was adjourned.