



MULTISTATE TAX COMMISSION

Working Together Since 1967 to Preserve Federalism and Tax Fairness

**Report of the Hearing Officer
Model Sales & Use Tax Notice and Reporting Statute**

May 31, 2011

I. Introduction and Summary

On April 11, 2011, the Executive Committee approved the proposed model Sales & Use Tax Notice and Reporting statute for public hearing. Under the proposal, sellers of a product that is delivered into a state who do not collect and remit sales or use tax for that state are required to: (1) notify purchasers at the time of transaction that tax is not being collected and may be due directly to the department, (2) provide purchasers an annual report showing their purchases, and (3) provide the department of revenue an annual report showing total dollar amount of each purchaser's purchases.

The hearing was held on May 18, 2011, after 30 days' notice. Written and oral comments were received from the American Institute of Certified Public Accountants and Washington State Department of Revenue. (Exhibits A and B). Although neither recommends specific changes to the language of the proposed model, both discuss important policy, legal, and administrative issues, such as constitutionality and compatible with the Streamlined effort. This report summarizes the proposal and its procedure history, reviews the public comment received, and recommends that the model be approved, without further amendment. (Exhibit C, Proposed Model Statute.) The hearing officer also recommends that the resolution adopting the model explicitly confirm the Commission's continued support for efforts, such as the Streamlined effort, to achieve collection and remittance by sellers as opposed to buyers.

The report and its recommendations are now before the Executive Committee for action. Executive Committee may either direct further study and consideration of the proposal or submit the report to the Commission along with the Executive Committee's own recommendation for action, which may include additional amendments. (*See* Commission bylaw 7(e)). If the Executive Committee recommends Commission action, then the proposal will be submitted to a bylaw 7 survey of affected Compact member states. (*See* Commission bylaw 7(g)). The bylaw 7 survey asks whether the state would consider adopting the proposal. If a majority of affected Compact member states respond affirmatively, the Chairman will submit the proposal for consideration at the Commission's annual business meeting in July, 2011.

II. The Proposal

A. Background and Procedural History

On March 3, 2010, the Uniformity Committee voted to begin developing a model statute, along the lines of a bill that had been introduced in the Colorado legislature just days earlier. A drafting group¹ was formed to develop a policy question list, which served as the basis for the Subcommittee's teleconference discussions on April 22, 2010; May 13, 2010; and June 22, 2010. On June 22, 2010, the Subcommittee completed its preliminary answers to the policy checklist and a draft model reflecting that policy direction was provided for Subcommittee discussion at its July, 2010 meeting. The draft was discussed and further developed at a subcommittee teleconference on September 30, 2010; an in-person meeting on December 7, 2010, and a teleconference on February 8, 2011. The Subcommittee then finalized the draft at its in-person meeting on March 1, 2011, and on March 2, 2011, the Uniformity Committee recommended the model favorably to the Executive Committee for submission to public hearing.

On April 11, 2011, the Executive Committee approved the model, without further amendment, for public hearing. The public hearing was held after 30 days' notice on May 18, 2011 in Washington, D.C. Two sets of written comments were received prior to the close of the public comment period on May 20, 2011:

Exhibit A American Institute of Certified Public Accountants (AICPA) – Patricia A. Thompson, CPA, Chair of Tax Executive Committee

Exhibit B Washington State Department of Revenue (WA DOR) – Tim Jennrich, Tax Policy Specialist

In addition, oral comments were received during the hearing from Tim Jennrich, WA DOR Tax Policy Specialist; Marc Hyman, AICPA Technical Manager; and Jamie Yesnowitz, Grant Thornton LLP Senior Manager, on behalf of AICPA.

B. Key Features

Stand-Alone Act: The model is designed so that it can be introduced as a stand-alone Act, rather than as part of the tax statute, because it does not impose a tax or require collection of a tax.

Notice and Reporting Required: Sellers that do not collect and remit state sales or use taxes on items delivered into the state must provide:

1. Notice to customers at the time of the transaction, as a public service to assist customers in understanding that tax is not being collected and that the customer may owe the tax directly to the department;

¹ The Drafting Group included Richard Cram (KS), Phil Horwitz (CO), Michael Fatale (MA) and MTC staff – Roxanne Bland and Shirley Sicilian.

2. Annual report to customers, as a public service to assist customers in remitting tax directly to the department; and
3. Annual report to the tax department, to assist it in identifying non-filers.

Exceptions: There are exceptions to these requirements for: (1) small sellers, (2) sellers with only de minimis in-state sales, and (3) sellers that are registered to collect the tax.

Penalties and Interest: Penalties apply for failure to provide notice or reports, and interest accrues on the penalty once it becomes final.

Confidentiality: All customer information received by the tax agency shall be treated as confidential taxpayer information.

Since the Commission began development of this proposal, three states have enacted or introduced similar legislation.²

III. Public Comment and Hearing Officer Recommendations

At the outset, the Hearing Officer wishes to thank the AICPA and the Washington State DOR for their insightful and helpful comments. Although neither recommends specific changes to the language of the proposed model, both discuss important policy, legal, and administrative issues. The AICPA concludes that the proposal should not be adopted. The Washington State DOR cautions that additional sales and use tax related issues should be addressed, or should continue to be addressed, if this proposal moves forward.

A. Policy Issues - Compatibility with the Streamlined Effort

The AICPA is concerned that adopting the model statute could undermine progress toward uniformity made through the collaborative work of the Streamlined project because it would unilaterally “force businesses in other states to collect simply to avoid burdensome notice and reporting requirements.” (AICPA, point 1, p.1) The hearing officer suggests, to the contrary, the proposal is compatible with, and even

² **Enacted:**

Colorado – §39-21-112(3.5), C.R.S. (2010) (notice and annual reports to purchaser and Department) <http://www.michie.com/colorado/lpext.dll?f=templates&fn=main-h.htm&cp=> ;
Oklahoma – Stat. §710:65-21-8 (Notice requirement only) <http://www.tax.ok.gov/rules/710-65-21-8%20ADOPTED.pdf>.

South Dakota – SB 146 (2011) session (requires notice)
<http://legis.state.sd.us/sessions/2011/Bills/SB146ENR.pdf>

Introduced:

California – AB 155 (notice and annual reports to purchaser and BOE)
http://www.leginfo.ca.gov/pub/11-12/bill/asm/ab_0151-0200/ab_155_bill_20110118_introduced.html ;

Hawaii – HB 1183 - (presumes entities with “click-through” affiliates have nexus, requires them to file annual report with the Department)
<http://www.capitol.hawaii.gov/session2011/bills/HB1183 .HTM>

complimentary to, the Streamlined effort. Although the proposal and the Streamlined effort both address the same basic problem – low consumers’ use tax compliance – each does so in a distinct and complimentary manner. The Streamlined effort is focused on encouraging remote *sellers* to collect and remit the tax, either purely voluntarily or as required by possible federal legislation. The proposal is focused on educating and assisting in-state *buyers* with their use tax responsibilities in situations *where the seller does not collect* and remit for them.

It is generally agreed that collection by sellers is a more efficient mechanism for administering sales and use taxes. As the streamlined project makes progress in that direction, it is a preferred approach. The Commission proposal would not change or interfere with that effort. It does not “force” sellers to collect sales tax, either directly by its terms or indirectly by imposing an unreasonable administrative burden (see discussion below). Rather, the proposal helps to educate buyers about their own use tax remittance responsibilities. The Washington State DOR points out that the proposal “does not address the substantial costs and barriers that will continue to exist with respect to collecting sales and use taxes from consumers directly.” And, for this reason, it is important to “support, or continue to support, a comprehensive solution that would give states remote seller collection authority over sellers through federal action, including federal legislation.” (WA DOR, bullet point 1)

In fact, the Commission expressed support for both seller collection and buyer notification when it adopted resolutions in support of each approach at the same July, 2000, Commission annual business meeting:

Commission Resolution in Support of Streamlined Sales Tax Project (No. 00-02):³

...RESOLVED, that the Multistate Tax Commission recognizes the value of the Streamlined Sales Tax Project to the tax systems of States that impose sales taxes, and to the state tax structure as a whole; and be it further

RESOLVED, that the Multistate Tax Commission commend those who are working on the project for their efforts; and be it further

RESOLVED, that States be encouraged to consider active participation in the project.....

And, Commission Resolution in Support of States Achieving Disclosure to Consumers of Their Potential Liability for Use Taxes (No. 00-05):⁴

³ MTC Resolution in Support of Streamlined Sales Tax Project (Resolution No. 00-2)
http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/About_MTC/Policy_S_and_R/2000/00-2.pdf

⁴ MTC Resolution in Support of States Achieving Disclosure to Consumers of Their Potential Liability for Use Taxes (Resolution No. 00-5)
http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/About_MTC/Policy_S_and_R/2000/00-5.pdf

...WHEREAS, all merchants have an obligation to inform their customers of the true, total cost of their purchases and any after-sale conditions attached to the ownership or use of the product being purchased; and WHEREAS, the failure of certain sellers to inform their customers in an adequate manner of the true cost of their purchases has justifiably led to government regulatory actions mandating disclosure, for example, of the true, effective rate of interest on consumer installment loans and of real estate settlement costs; and WHEREAS, the legal obligation to pay use taxes is an additional element of the cost of making remote purchases and direct marketers are, of course, well aware of this; and...now, therefore, be it RESOLVED, that the Multistate Tax Commission urge all direct marketers to include in all of their sales solicitations, written and oral, a disclosure that their customers may owe use taxes on their purchases and should contact their tax agencies for information on how they may fulfill this obligation...

The Hearing Officer believes these two approaches complement each other by addressing seller collection on the one hand; and buyer education and compliance on the other. Therefore, the Hearing Officer disagrees with AICPA's contention that the proposed model "undermines the work of the Streamlined Sales and Use Tax Project." Rather, the Hearing Officer agrees with the Washington State DOR, and finds that, because reasonable approaches for achieving state collection authority over remote sellers continue to be appropriate, our continued support for these approaches should be emphasized to ensure momentum in that direction is not jeopardized. To accomplish this, the Hearing Officer recommends that any resolution adopting all, or any part, of this proposed model should explicitly confirm the Commission's continued support for the Streamlined effort and seller collection approaches generally, consistent with Resolution 00-05.

B. Legal Issues - Constitutionality

As mentioned above, the Commission proposal is based on a sales & use tax notice and reporting statute recently enacted in Colorado. Soon after Colorado enacted its statute, the Direct Marketing Association filed suit in the U.S. District Court for the District of Colorado arguing that the new law violates several state and federal constitutional provisions, including the dormant commerce clause, right to privacy, and right to free speech.⁵ In January, 2011, the District Court granted DMA's motion to preliminarily enjoin Colorado from administering its statute while the lawsuit is pending. The Court granted DMA's motion because it found DMA is likely to succeed on its dormant commerce clause argument.⁶

⁵ *Direct Marketing Association v. Roxy Huber, in her capacity as Executive Director, Colorado Department of Revenue*, United States District Court for the District of Colorado, Civil Action No. 10-cv-01546-REB-CBS.

⁶ The parties have now filed cross motions for summary judgment on that issue; and the Court has agreed to certify its decision on those cross motions for appeal. The other constitutional arguments will be stayed,

In light of this early-stage loss, AICPA comments that “a proposed model statute based on a law that is currently being challenged on constitutional grounds, and which is likely to be struck down in that challenge, simply should not be used as a template for other states’ use.” (AICPA, point 5, p.4) The Hearing Officer suggests a broader view is called for. First, the Hearing Officer disagrees that either the Colorado statute or Commission proposal violates the Constitution. Second, there would be costs, as well as benefits, associated with waiting for this issue to be conclusively resolved. The hearing officer believes that when the magnitude and likelihood of both costs and benefits are considered, the analysis weighs in favor of proceeding with the proposal.

1. Does the Commission Proposal Discriminate or Impose an Undue Burden in Violation of the Constitution?

Neither AICPA nor Washington State DOR argue that the proposal violates the United States Constitution in any way. However, the AICPA suggests that the proposal would saddle out-of-state sellers with an unnecessary burden so significant that it would exceed the benefit to the state and cause these sellers to submit to State collection and remittance requirements, like in-state sellers, instead. (AICPA points 2, 3, 4; pp. 1-3).

If this proposal truly burdened interstate commerce relative to in-state commerce – as AICPA suggests – the proposal could arguably be discriminatory in violation of the dormant commerce clause. (AICPA, point 3, p. 4) Indeed, the Federal District Court in Colorado preliminarily found that although the Act does not explicitly target out-of-state sellers, it is likely to ultimately be determined discriminatory because “in practical effect, [it] impose[s] a burden on interstate commerce that is not imposed on in-state commerce.”⁷ But this comparison is incomplete.⁸ It only takes into consideration the requirements imposed on interstate sellers. To *compare* the treatment of interstate sellers with in-state sellers, one must consider the requirements imposed on in-state sellers as well.⁹ And in making this comparison, it is not enough to show that the requirements are

pending the ultimate resolution of the dormant commerce clause issue. The decision granting preliminary injunction is available at:

<http://www.thedma.org/segment/segmentfiles/catalogers/20110126OrderGrantingPI.pdf>.

⁷ *Direct Marketing Association v. Roxy Huber, in her capacity as Executive Director, Colorado Department of Revenue*, USDC Dist. of Co., Civil Action No. 10-cv-01546-REB-CBS, Order Granting Motion for Preliminary Injunction (January 26, 2011)

⁸ It should also be mentioned that the proposal does not literally distinguish between in-state and interstate commerce. It distinguishes between sellers that are required to collect and remit the tax and those that are not required to collect and remit the tax. Under current U.S. Supreme Court precedent, this distinction is in-state and interstate sellers with a physical presence vs. interstate sellers without a physical presence. Interstate sellers that have no physical presence in a state would be subject to the requirements of the proposal.

⁹ *See, West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994) (other related laws should be taken into account in determining whether an Act discriminates in violation of the dormant commerce clause.)

simply different – rather, the dormant commerce clause is violated only if the difference creates an advantage for in-state commerce at the expense of interstate commerce.¹⁰

When a proper comparison is made, it appears unlikely that the proposal would burden interstate remote sellers to such an extent they would be placed at a disadvantage relative to in-state sellers. At the time of each transaction, an in-state seller must know the state and local tax rates and communicate these rates to the buyer; calculate the amount of tax due on the transaction and communicate that amount to the buyer; evaluate tax exemption certificates supplied by the buyer; and, if no exemption applies, collect the tax due. Then, at regular intervals throughout the year, the in-state seller must complete and file a tax return with the department and remit the tax collected during that interval to the department. The in-state seller may also be required to process buyers' refund requests. In order to perform these obligations, the in-state seller must seek and obtain a license from the State. The in-state seller has on-going responsibility to create and maintain records, and may be subject to audit. In contrast, the proposal simply requires remote sellers to notify buyers that a state tax may be due, to submit a report to the department once a year, and to submit a report to each in-state buyer once a year (*See* Commission Proposal, Exhibit A, §§(c)(1)-(3)). Thus, the Hearing Officer believes that the reasonable requirements imposed on remote sellers under the proposal are not more burdensome than the reasonable requirements currently imposed on in-state sellers under state sales and use tax laws.

Even if a state law is found to be discriminatory, it may still be upheld as constitutional if it serves a legitimate state purpose and there is no reasonable, nondiscriminatory alternative.¹¹ AICPA suggests interstate remote sellers need not be subject to the requirements of the Commission proposal because “there are other ways to address the problem of low use tax compliance rates,” including: remittance lines on individual and business entity income tax returns; clearer tax form instructions; targeted amnesty programs; a safe harbor allowing taxpayer's to report a percentage of gross income instead of the actual amount due; and educating citizens through mass mailings, radio, and television advertisements. (AICPA, point 2, pp.3-4) These are good suggestions that could be adopted in addition to the proposal – indeed some are already in place in some states – but none is truly a substitute for the requirements of the proposal. Income tax return lines and clear tax forms enable taxpayers to remit the use tax once they know it is due, but these are remittance processes. They do not focus on helping taxpayers understand that the tax is due, as the notice requirements of the proposal would. Nor do they help taxpayers calculate the amount of the tax due, as the year-end report to consumers would. And they do not assist the department in carrying out its charge to enforce the tax, as the year-end report to the department would. Amnesty programs and safe harbor payment options are helpful on an occasional basis, but they are not aimed at promoting proper long-term enforcement or administration of the tax, as the reports to customers and the department are. Likewise, mass mail, radio, and television

¹⁰ *See, Reeves, Inc. v. Stake*, 447 U.S. 429, 437 (1980) (prohibiting a differential treatment that discriminates against interstate commerce).

¹¹ *Or. Waste Systems, Inc. v. Dep't of Environmental Quality of the State of Or., et al.*, 511 U.S. 93 (1994).

advertisements may help educate taxpayers, and there is no reason these cannot be provided by the state in addition to the notices required to be provided by the seller under the proposal. But mass advertising is a blunt instrument. It may or may not reach in-state taxpayers purchasing from sellers that are not collecting and remitting the tax. In contrast, the notice required by the proposed model would reach exactly those individuals. The Hearing Officer agrees that there are additional efforts that could be undertaken, but does not agree that these alternatives serve the same administrative and enforcement purposes of the proposed model statute.

A law that does not discriminate against interstate sellers may none-the-less violate the dormant commerce clause if it creates – as AICPA believes the proposal does – burdens on commerce that are excessive in relation to state benefits.¹² AICPA suggests the notice and department reporting required under the proposal may have little benefit because buyers may ignore the notice at the time of transaction, and the department may not have the resources necessary to make use of the data reported. (AICPA, point 4, pp. 4-5) Certainly some buyers may ignore the notice. But many simply do not understand they are obligated to pay the tax to the department if it is not collected by the seller. The notice required under the proposed model, if implemented as intended, is critical to eliminating the impression that tax is not due. Reporting to the state is also critical, so that buyers can realize that the state has the ability to enforce the tax. (If the reports are filed electronically, they should be adequately accessible for enforcement purposes.) In this environment of poor understanding and low compliance, the notice and reporting required under the proposal will produce significant benefits because they are essential to states’ strong interest in effectively administering and enforcing their sales and use taxes.

In sum, the Hearing Officer believes that the proposal’s notice and reporting requirements are an administratively efficient means of administering and enforcing sales and use tax without discriminating against, or imposing an undue burden upon, interstate commerce. As such, the proposed model helps to eliminate the perception and practical reality that in-state sales are subject to tax while interstate remote sales are not. Thus, the proposal effectively promotes the fundamental objective of the commerce clause, which is to preserve level competition in national markets.¹³

2. Should the Commission Proposal be Stayed Pending Conclusion of Litigation?

As noted above, the AICPA recommends against adopting a model based on a law which is currently being challenged. Similarly, the Washington State DOR notes that it is unclear what the ultimate outcome will be if the concept is further litigated and suggests considering “whether it makes sense to adopt a model approach now before the idea has had time to be more fully developed through experimentation in the laboratory of the

¹² *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970).

¹³ *See H.P. Hood & Sons, Inc. v. Du Mond*, 336 U.S. 525 (1949). *See also, General Motors v. Roger W. Tracy, Tax Commissioner of Ohio*, 519 U.S. 278 (1997) (the dormant commerce clause’s fundamental objective is preserving national markets for competition undisturbed by preferential advantages conferred by a State upon its residents or resident competitors)

many states.” (WA DOR, 4th bullet point). The benefit of waiting to propose a model until its legal issues are conclusively resolved is, of course, certainty. But it could be a long time before such certainty is achieved in this matter. The Colorado litigation is in its early stage, with only one federal district court determination and only on preliminary injunction. And as the concept is tested in other state or federal Courts, those Courts may view the issues differently than the Colorado court.

Meanwhile, state commentators have recommended states consider adopting this or similar approaches, beginning as early as 2000 when the Commission issued its Resolution in Support of States Achieving Disclosure to Consumers of Their Potential Liability for Use Taxes (Res. No. 00-05). More recently, a published article by experts at the New York State Department of Taxation and Finance reviews the constitutional issues and recommends, consistent with the proposed model, that states require sellers to make reports to the department and provide notice to buyers:

[S]tates should seek to assert due process nexus when the facts do not support commerce clause nexus. For example, a state could not, under current law, impose sales tax collection duties on a pure e-tailer ... despite millions of dollars of sales by the e-tailer to in-state customers. The state could, however, successfully assert due process nexus under *Quill* and on that basis require the e-tailer to submit information returns providing data on sales by the e-tailer delivered to customers in the state. The e-tailer would not be required to make any determination as to the tax status of a transaction or the correct amount of tax. It would not be asked to invoice, collect, or pay over the tax, which was the burden cited in *National Bellas Hess* and *Quill*. Rather, it would simply be required to transmit data from its own records in a form that would allow the state to pursue use tax from its own residents. A state could also assert due process nexus to require e-tailers to disclose to customers making purchases for delivery into the state, at the time of the transaction, some or all of the following information:

- that their purchases, if taxable when purchased at a store in the state, are also taxable when purchased from a remote vendor even when the vendor doesn't collect the tax;
- how to pay the tax directly to the state;
- that the state may require the remote vendor to provide it with transaction information regarding purchases delivered into the state; and
- that taxpayers failing to timely pay the required tax are subject to interest and penalties.

A New Way Forward for Remote Vendor Sales Tax Collection; Robert Plattner, Daniel Smirlock, and Mary Ellen Ladouceur; Tax Analysts Special Report; January 18, 2010; p. 187, 194.

Colorado and two other states have now enacted laws along these lines, and legislation has been introduced in others.¹⁴ Having a model available now – one that has benefited from the input of tax experts in multiple states through the Commission uniformity process – would assist states in adopting legally sound legislation in the first place. A model available now would also assist states in adopting more uniform legislation, which is important to minimizing the potential for administrative burden on interstate remote sellers. Several states have enacted New York style associate nexus legislation, despite the fact that litigation on that concept is not final in even one state, and the Commission’s uniformity committee is only now beginning to consider a similar model. The longer the Commission waits to adopt a notice and reporting model, the less need there will be for one as states unilaterally consider and enact their own versions of the legislation. The Hearing Officer believes that this proposed notice and reporting model is sufficiently well grounded in constitutional principle, and will be of sufficient benefit to the states, to justify Commission adoption at this time.

C. Administrative Issues –Seller and Buyer Perspectives

Because the proposal imposes notice and reporting responsibilities, it creates administrative obligations, and both AICPA and Washington State DOR address some of these in their comments. AICPA raises administrative concerns for sellers. Most of these are discussed above in the context of states’ constitutional limitations in imposing burdens on interstate commerce. In addition, AICPA lists the multiple activities sellers will be required to perform under the proposed model and points out that “this compliance burden will substantially increase as the number of states adopting the model statute grows.” (AICPA, point 4, pp. 4-5) The Hearing Officer suggests that this point may weigh in favor of adopting a model in order to promote uniformity and minimize the potential burden of multiple different state notice and reporting requirements.

The Washington State DOR points out that the model does not offer solutions for administrative issues that will be faced by the ultimate taxpayer, the buyer. (WA DOR, bullet point 2). By way of example, Washington State notes that some, but not all, states provide a remittance line on the state’s income tax return. To the extent the proposal could successfully result in more use tax compliance by consumers, it could exacerbate administrative shortcomings that currently exist in the states. It is true that this model does not address those sorts of issues. The Hearing Officer suggests states that adopt this model will want to make sure their consumer use tax remittance processes are adequate to handle increased compliance. The Washington State DOR also points out that not all sales and use tax sourcing issues have been resolved in all states (for example, digital goods sourcing) and suggests this could lead to confusion on where notices must be sent with the possible result that sellers may send notice to multiple states. (WA DOR, bullet points 2 and 3) In recognition that sourcing rules will continue to be developed by states acting upon their own or through co-operative efforts, the model does not require the seller to know where the transaction is sourced under any particular state law. The model only requires the seller to send notice to the “purchaser,” and “purchaser” is defined as “any person who purchases or leases a product for delivery to a location in this state.”

¹⁴ See footnote 2.

V. Conclusion

The Hearing Officer recommends the proposal be adopted, without further amendment, and that the resolution evidencing this adoption explicitly confirm the Commission's continued support for efforts to achieve collection and remittance by sellers as opposed to buyers.

Respectfully Submitted,

Shirley K. Sicilian
Hearing Officer



May 18, 2011

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Re: MTC Draft Model Sales & Use Tax Notice and Reporting Statute (Dated April 18, 2011)

Dear Mr. Huddleston and Ms. Sicilian:

In May 2010, Ms. Sicilian asked the AICPA's State & Local Taxation Technical Resource Panel (SALT TRP) for input on the MTC Model Sales & Use Tax Notice and Reporting Statute (Model Statute), which at that time was still in the Policy Checklist phase. Our comments below, prepared by our SALT TRP and approved by our Tax Executive Committee, relate to the published [MTC draft dated April 18, 2011](#). We appreciate the offer to provide our specific input.

The proposed uniform statute incorporates concepts contained in legislation recently adopted by the state of Colorado.¹ The Colorado Department of Revenue has been enjoined and restrained by the U.S. District Court of Colorado from enforcing that legislation and the accompanying regulations based on, among other reasons, likelihood that the alleged constitutional challenges of discrimination and undue burden brought in a complaint filed by the Direct Marketing Association will be upheld.

The MTC Model Statute is designed to impose uniform sales and use tax notice and reporting requirements on out-of state retailers towards both consumers and Departments of Revenue. For the reasons specified in the following pages, the AICPA believes that the MTC draft should **not** be adopted.

The AICPA is the national professional organization of certified public accountants comprised of nearly 370,000 members. Our members advise clients on federal, state and international tax matters, and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized business, as well as America's largest businesses.

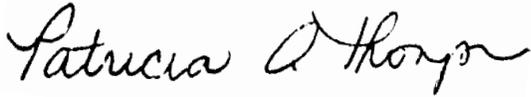
If you have any questions, please contact me at (401) 831-0200 or patt@pgco.com; Harlan J. Kwiatek, Chair of the State and Local Taxation Technical Resource Panel at (314) 290-3271 or

¹ CO H.B. 10-1193; §39-21-112(3.5)

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Harlan.kwiatek@rubinbrown.com; or Marc A. Hyman, AICPA Technical Manager at (202) 434-9231 or mhyman@aicpa.org.

Sincerely,

A handwritten signature in black ink that reads "Patricia A. Thompson". The signature is written in a cursive style and is positioned above the printed name and title.

Patricia A. Thompson, CPA
Chair, Tax Executive Committee

cc: Greg Matson, MTC Deputy Director
Elliott Dubin, MTC Director of Policy Research

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Comments to the Multistate Tax Commission
Draft Model Sales & Use Tax Notice and Reporting Statute (Dated April 18, 2011)

May 18, 2011

The AICPA believes that the MTC draft Model Sales & Use Tax Notice and Reporting Statute (Model Statute) should **not** be adopted for the following reasons:

1. The MTC Model Statute undermines the work of the Streamlined Sales and Use Tax Project.

For over ten years, the Streamlined Sales and Use Tax Project has made efforts to modernize state sales and use tax laws and create uniformity among the numerous sales tax jurisdictions in this country. With input from state taxing agencies, businesses and lawmakers, a model sales tax act—the Streamlined Sales and Use Tax Agreement—has been drafted and over twenty states have conformed their laws to the definitions and provisions contained in the Agreement. One impetus behind the effort to simplify state sales and use tax laws is the potential that Congress will adopt legislation partially overturning *Quill's* physical presence requirement, thus requiring non-collecting retailers making sales into “Streamlined” states to collect and remit sales tax. Should this occur, it is expected that sales tax revenue loss associated with e-commerce will be reduced.

Although federal legislation has not yet been enacted, those involved in the Streamlined effort have attempted to confront the issue of revenue loss associated with e-commerce by making state sales tax regimes simpler and more uniform. These efforts do not involve coercion or side-stepping constitutional barriers. The years of collaboration and the give and take involved in the Streamlined effort would be significantly undermined if states could essentially force businesses in other states to collect simply to avoid burdensome notice and reporting requirements.

The MTC, as an organization that promotes uniformity among states, including many states that are actively involved in the Streamlined process, should not adopt a model statute that ignores the uniformity and collaborative achievements made within the Streamlined project.

2. Out-of-state businesses that are not required to collect and remit sales tax should not be required to police individual use tax noncompliance.

The Model Statute essentially puts the burden of policing purchaser use tax compliance on out-of-state businesses. While we recognize, as noted earlier, that states are dealing with serious budget issues, there are other ways to address the problem of low use tax compliance rates. One way is through better educating citizens of their use tax obligations such as through mass mailings, radio and television advertisements, clearer tax form instructions and targeted amnesty programs. Another option that has been adopted by

several states is to insert a line item on individual and business entity income tax returns where taxpayers are required to report use tax owed on remote purchases. Yet another option is for a state to provide an optional safe harbor allowing the taxpayer to report an amount equal to a percentage of the taxpayer's adjusted gross income in that state instead of the actual amount of their use tax.

While use tax noncompliance is a serious concern, out-of-state retailers should not be burdened with enforcement of the use tax laws in states in which they do not have a physical presence.

3. The Model Statute would likely compel businesses that are not required to do so under *Quill* to collect sales and use tax; forcing this result through the imposition of a burdensome reporting regime is bad tax policy.

One of the major criticisms of Colorado's information reporting requirements is that the state essentially coerces out-of-state businesses into collecting Colorado sales and use tax as a way for such businesses to opt out of complying with the state's information reporting requirements and the potential penalties associated with noncompliance or error. The Model Statute, as written, would have the same effect.

We recognize that revenue loss associated with use tax noncompliance is a serious concern for the states, particularly in light of widespread deficits that many states are still experiencing. However, as a matter of tax policy, states should not be able to require out-of-state businesses to report vast amounts of information to in-state consumers and state taxing authorities. These requirements, particularly the reporting requirements, clearly obligate these out-of-state businesses to perform tasks and expend effort that is more appropriately undertaken by the relevant state tax authorities themselves thus blurring the line between the responsibilities appropriate to businesses that collect and remit sales and use taxes to a particular state, and business that do not have such responsibilities.

Businesses should have some level of certainty as to whether they have to fulfill sales and use tax compliance obligations. If they do not have actual physical presence in a state, they should not be subjected to a process, such as the one advocated by the Model Statute, of collecting and remitting information to both in-state customers and the Department of Revenue that is equally or more burdensome than had they been subject, under *Quill*², to sales and use tax collection requirements for that state. Clearly, this violates the "undue burden" analysis of *Quill* and related cases.

4. The costs of compliance with the Model Statute are likely to far outweigh the benefits received by the states receiving the reported information.

Businesses will incur new or increased costs of compliance under the model statute, while governments may not have the resources to utilize or take advantage of additional information provided by expanded reporting. The benefits of this additional information most likely will *not* justify the additional costs to businesses.

² *Quill Corp v. North Dakota*, 504 U.S. 298 (1992)

Costs

For out-of-state and other retailers who do not collect and remit sales taxes to a state, the costs of complying with a law based on the Model Statute will be significant. Businesses will have to dedicate human and material capital to:

- reprint their paper invoices, purchase orders and sales/lease receipts to display statutorily required boilerplate language that may likely be ignored by most purchasers;
- reprogram their website pages that replicate invoices, purchase orders and sales receipts to display the same information;
- produce an annual report to each of its in-state purchasers, under threat of penalty for omissions, detailing the type of product purchased or leased, how to remit the tax to the state authority and other information;
- keep track of each state's required method for use tax remittance by taxpayers so that the business is able to properly inform the taxpayers in the annual report;
- complete and submit an accurate, annual report to the applicable state tax authority, under threat of substantial penalties, listing all of the business' in-state purchasers, multiple addresses for each purchaser, dollar amounts and other information.

This compliance burden will substantially increase as the number of states adopting the Model Statute grows.

Benefits

It is not clear how receipt of information on thousands of internet purchases will translate into revenue for the states. Given the lack of resources most state taxing agencies are facing in light of recent state budget cuts, it is unlikely that states are equipped to handle collecting, compiling and analyzing the voluminous amount of information that will be required to be reported. Thus, the information—reported at great cost to non-collecting retailers—will not readily enable a state to collect unpaid use taxes.

Again, it would certainly appear to be the hope of states that enacting such a notice and reporting statute would compel out-of-state and other non-collecting retailers to start collecting the sales tax as a means to avoid compliance with the information reporting statute. This would seem to be the only way a significant amount of revenue could be generated with minimal administrative cost to the states.

The information reporting and notice rules impose significant financial burdens on non-collecting retailers and promise little discernable benefit for states outside of compelling collection and remittance of the sales tax.

5. The principles addressed in the draft Model Statute, if adopted by the states, will continue to be challenged on constitutional grounds.

The Direct Marketing Association (DMA), in its lawsuit alleging that Colorado's reporting requirements violate the U. S. and Colorado Constitutions, have already been successful in obtaining an injunction in the Federal District Court of Colorado. The lawsuit alleges that the enactment:

- discriminates against out-of-state retailers lacking physical presence in the state relative to in-state retailers;
- imposes an improper and burdensome regulation of interstate commerce;
- tramples the right to privacy of Colorado residents and certain nonresidents;
- chills the exercise of free speech by certain purchasers and vendors of products that have expressive content;
- exposes confidential information regarding consumers and their purchases to the risk of data security breaches; and
- deprives retailers, without due process or fair compensation, of both the value of their proprietary customer lists and the substantial investment made to protect such lists from disclosure.

On January 26, 2011, the court issued a preliminary injunction that blocks the Colorado Department of Revenue's enforcement of the notice and reporting requirements on out-of-state retailers while the DMA case is pending. The court ruled that DMA has shown a substantial likelihood of success on its constitutional claims.

A proposed model statute based on a law that is currently being challenged on constitutional grounds, and which is likely to be struck down in that challenge, simply should not be used as a template for other states' use.

Loretta King

From: Jennrich, Timothy (DOR) <TimJe@DOR.WA.GOV>
Sent: Thursday, May 12, 2011 5:20 PM
To: Loretta King
Cc: Gil Brewer; Chris Coffman; Potegal, Greg; Russ Brubaker
Subject: Proposed Model Sales and Use Tax Notice and Reporting Statute

Dear Ms. King:

The State of Washington thanks the Multistate Tax Commission (MTC) for its efforts in this area and for giving us the opportunity to provide comments related to the "Proposed Model Sales and Use Tax Notice and Reporting Statute." Washington state relies heavily on sales and use taxes to fund state services and we are acutely aware of the problems posed by the issue of remote seller collection authority, which this model proposal is designed, in part, to address. With this background in mind we have the following comments:

- **Incomplete solution:** The proposed model act does much to help notify consumers of their tax obligations and may result in some increased tax collections from voluntary compliance and targeted enforcement. However, the solution is incomplete and does not address the substantial costs and barriers that will continue to exist with respect to collecting sales and use taxes from consumers directly. Therefore, we think it is important that the states recognize the limited utility of this approach and strongly support or continue to support a comprehensive solution that would give states remote seller collection authority over sellers through federal action, including federal legislation.
- **Taxpayer convenience and compliance:** A purpose of the MTC Tax Compact is to promote uniformity in significant components of tax systems and to facilitate taxpayer convenience and compliance in administration. This proposal focuses on the sellers of goods, but does not offer solutions for the ultimate taxpayer relating to administration. Admittedly, some states provide a method for use tax compliance that may compliment the proposed model act, but for taxpayers in states like Washington that does not have an income tax return for use tax reporting the options are less clear. If this proposal moves forward, this issue should be addressed.
- **Sourcing of sales and digital products:** A purpose of the MTC Tax Compact is to promote compatibility in significant components of tax systems. This proposal requires notice for sales or leases subject to tax in a state. However, the proposal does not adopt or recommend any consistent method of sourcing. Therefore, it is possible that two states adopting this proposed model act may subject a single transaction to the seller notice requirements and related penalties. This is especially likely in the area of digital products. This situation creates great potential that sellers will have to send notices to multiple states for the same taxpayer or face penalties. It is unclear how this result would promote compatibility in significant components of tax systems. If this proposal moves forward, this issue should be addressed.
- **Issue development:** This approach has been the subject of recent litigation and it is unclear what the ultimate outcome will be if further litigated. However, the MTC membership should consider whether it makes sense to adopt a model approach now before the idea has had time to be more fully developed through experimentation in the laboratory of the many states.

Thank you again for allowing Washington this opportunity to these provide comments.

Very truly yours,

/s/

Tim Jennrich

WA Department of Revenue

Exhibit C



MULTISTATE TAX COMMISSION

Working Together Since 1967 to Preserve Federalism and Tax Fairness

Draft Model Sales & Use Tax Notice and Reporting Act
As Approved by Executive Committee for Public Hearing – April 11, 2011

- (a) **Administration.** The [State Department of Revenue] shall perform all functions necessary and proper for the administration and enforcement of this Act, including promulgating regulations and reviewing protests in accordance with the [State Administrative Procedures Act].
- (b) **Definitions.** For purposes of this Act:
- (1) **“Department”** means the [State Department of Revenue].
 - (2) **“Director”** means the Director of the [State Department of Revenue].
 - (3) **“Purchaser”** means any person who purchases or leases a product for delivery to a location in this state.
- (c) **Notice and Reports, Required.** A person who sells or leases a product; the storage, use, or consumption of which is subject to [State Use Tax Act], or the sale or lease of which is subject to [State Sales Tax Act]; but who does not collect and remit either such tax, shall provide the following notice and reports.
- (1) **Notice to Purchaser at Time of Transaction.** A notice shall be provided to each purchaser at the time of each such sale or lease.
 - (A) The notice shall indicate that neither sales nor use tax is being collected or remitted upon the transaction, and that the purchaser may be required to remit such tax directly to the Department.
 - (B) The notice shall be prominently displayed on all invoices and order forms, including, where applicable, electronic and catalogue invoices and order forms, and upon each sale or lease receipt provided to the purchaser. No indication shall be made that sales or use tax is not imposed upon the transaction, unless: (i) such indication is followed immediately with the notice required by this section (c)(1); or (ii) the transaction with respect to which the indication is given is exempt from [State] sales and use tax pursuant to [State] law.
 - (2) **Annual Report to Purchaser.** A report shall be provided to each purchaser before January 31st of each year.
 - (A) The report shall include:

- (i) a statement indicating that the person did not collect sales or use tax on the purchaser's transactions and that the purchaser may be required to remit such tax directly to the Department;
- (ii) a list, by date, generally indicating the type of product purchased or leased during the prior calendar year by the purchaser from such person for delivery to a location in this state and the price of each product;
- (iii) instruction for obtaining additional information regarding whether and how to remit the sales or use tax to the Department;
- (iv) a statement that such person is required to submit a report to the Department pursuant to section (c)(3) of this Act stating the total dollar amount of the purchaser's purchases; and
- (v) any information as the Director shall reasonably require.

(B) The report shall be sent to the purchaser's billing address, or if unknown, the purchaser's shipping address, in an envelope marked prominently with words indicating important tax information is enclosed. If no billing or shipping address is known, the report shall be sent electronically to the purchaser's last-known e-mail address with a subject heading indicating important tax information is enclosed.

(3) Annual Report to [State Department of Revenue]. A report shall be provided before January 31st of each year to the Department.

(A) The report shall include, with respect to each purchaser:

- (i) the name of the purchaser;
- (ii) the billing address and, if different, the last known mailing address;
- (iii) the shipping address for each product sold or leased to such purchaser for delivery to a location in this state; and
- (iv) the total dollar amount of all such purchases by such purchaser which were made during the prior calendar year for delivery to each such address.

(B) The report shall be filed electronically in the form and manner required by the Director.

(d) Exceptions.

(1) Small Seller. A person who made less than \$A [original SST threshold for small seller was \$100,000] in total gross sales during the prior calendar year shall not be required to provide notice or file reports pursuant to section (c) of this Act.

(2) De minimis In-State Sales. A person who made less than \$B [CO: \$100,000] in total gross sales for delivery to a location in this state during the prior calendar year shall not be required to provide notice or file reports pursuant to section (c) of this Act.

[(3) Sales by Registered Vendors. A person who is registered to collect and remit sales and use tax, and who complies in good faith with the [State Sales and Use

Tax Acts], shall not be required to provide notice or file reports pursuant to section (c) of this Act.

(e) **Penalties.**

- (1) **Amount.** The Director shall assess a penalty upon any person who fails to provide notices and reports as required by this Act as follows:
- (A) **Penalty for Failure to Provide Notice to Purchaser at Time of Transaction.** A person who fails to provide notice as required by section (c)(1) shall be assessed a penalty, in addition to any other applicable penalties, in the amount of \$X for each such failure, not to exceed:
- (i) a total of \$Y in one calendar year, if such person remedied each failure by providing such notices within X days of the date such notice was required to be provided, and
 - (ii) a total of \$Z in one calendar year where section (e)(1)(A)(i) of this Act does not apply
- (B) **Penalty for Failure to Provide Annual Report to Purchaser.** A person who fails to provide a report as required by section (c)(2) shall be assessed a penalty, in addition to any other applicable penalty, of \$X for each such failure, not to exceed:
- (i) a total of \$Y in one calendar year if such person remedied each failure by providing such notices within X days of the date such report was required to be provided, and
 - (ii) a total of \$Z in one calendar year where section (e)(1)(B)(i) of this Act does not apply.
- (C) **Penalty for Failure to Provide Annual Report to Department.** A person who fails to provide a report as required by section (c)(3) shall be assessed a penalty, in addition to any other applicable penalty, equal to \$X times the number of such purchasers that should have been included on such report, not to exceed:
- (i) a total of \$Y in one calendar year if such person remedied the failure by providing the report within X days of the date such report was required to be provided, and
 - (ii) a total of \$Z in one calendar year where section (e)(1)(C)(i) of this Act does not apply.
- (2) **Estimates Authorized.** When assessing a penalty pursuant to section (e) of this Act, the Director may use any reasonable sampling or estimation technique where necessary or appropriate to determine the number of failures in any calendar year.
- (3) **Protest.** A person may protest the assessment of any such penalty or interest by filing a written objection with the Director within [number of days equal to the number of days allowed for protest of a use tax assessment or refund denial] days of the date of assessment. Disposition of a timely filed protest shall be in accordance with [State Administrative Procedures Act]. If no such protest is filed within the time allowed, the assessment shall become final and subject to [judgment, warrant, collection procedures].

- (4) **Interest.** Interest shall accrue on the amount of the total penalty that has been assessed and become final for each calendar year pursuant to section (e) of this Act at the rate established pursuant to [state code section setting interest rate for tax underpayment].
- (5) **Waiver.** Upon written request received within the time established for protest pursuant to section (e)(4) above, the Director, in his or her sole discretion, may waive any portion or all of the penalty or interest applicable under this section for good cause shown.
- (f) **Confidentiality of Purchaser Information.** Information received by the [State Department of Revenue] pursuant to this Act shall be exempt from any disclosure required pursuant to [State Open Records Act]. Such information shall be treated as confidential taxpayer information pursuant to [cite to open records exception for confidential taxpayer information, including exceptions statutes] and all exceptions, penalties, punishments, and remedies applicable to disclosure of confidential taxpayer information pursuant to [cite to statutes regarding confidential taxpayer information disclosure exceptions and penalties] shall apply to disclosure of information received by the Department pursuant to this Act.
- (g) **Limitations.** Nothing in this Act shall relieve a person who is subject to [the state's sales tax act or the use tax act] from any responsibilities imposed thereunder. Nor shall anything in this Act prevent the Director from administering and enforcing [the state's sales tax act or the use tax act] with respect any person who is subject thereto.
- (h) **Severance.** The provisions of this Act are severable and if any section, sentence, clause or phrase of this Act shall for any reason be held to be invalid or unconstitutional, such holding shall not affect the validity of the remaining sections, sentences, clauses, and phrases of this Act, which shall remain in effect.