June 13, 2018

Ms. Loretta King
Multistate Tax Commission,
444 N. Capitol Street, N.W., Suite 425
Washington, DC 20001-1538

Re: Multistate Tax Commission (MTC) Draft Model Sales and Use Tax Notice and Reporting Statute (Dated April 25, 2018)

Dear Ms. King:

The American Institute of CPAs (AICPA) is submitting the attached comments and requests to testify at the June 14, 2018 hearing on the Multistate Tax Commission (MTC) Draft Model Sales and Use Tax Notice and Reporting Statute dated April 25, 2018 (Draft Model Statute). These comments update our prior AICPA comments submitted May 18, 2011 on the previous (April 18, 2011) version of the MTC model sales and use tax notice and reporting statute.

The Draft Model Statute incorporates concepts contained in legislation recently adopted by several states,[1] and is designed to impose uniform sales and use tax notice and reporting requirements on out-of-state retailers towards both consumers and the state tax authorities.

As detailed in the attached comments, the AICPA has significant concerns with the Draft Model Statute, for the following reasons:

1. The Draft Model Statute should not require out-of-state businesses that do not have any obligation to collect and remit sales tax to police use tax noncompliance at the businesses' own expense. There are low-cost, comprehensive, and more appropriate techniques for states to assist in-state consumers in meeting their use tax obligations.

2. The Draft Model Statute would likely compel sales and use tax collection by businesses that are not required under *Quill* to collect sales and use tax. Forcing this result through the imposition of a burdensome reporting regime is contrary to good tax policy.

3. The costs of compliance with the Draft Model Statute outweigh the benefits received by the states receiving the reported information.

4. The Draft Model Statute exceeds the conventional principles of sales and use tax, which will lead to further complications and burdens on all parties involved.

[1] *See, e.g.*, Alabama (Ala. L. 2018 539 § 3), Colorado (Colo. Rev. Stat. § 39-21-112(3.5)), Georgia (GA House Bill 61), Kentucky (Ky. Rev. Stat. Ann. § 139.450), Louisiana (La. Rev. Stat. Ann. § 47:309.1), Oklahoma (Okla. Stat. 68 § 1392), Pennsylvania (Pa. Stat. Ann. 72 § 7213.1), Rhode Island (R.I. Gen. Laws § 44-18.2-3), South Dakota (S.D. Codified Laws § 10-63-2), Vermont (Vt. Stat. Ann. 32 § 9712), and Washington (Wash. Rev. Code § 82.08.053).

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We appreciate your consideration of these comments and welcome the opportunity to testify at the June 14, 2018 hearing. If you have any questions, please contact Catherine Stanton, Chair of the AICPA State and Local Tax Technical Resource Panel, at (240) 396-1076, or cstanton@cbh.com; Eileen Sherr, AICPA Senior Manager – Tax Policy & Advocacy, at (202) 434-9256 or eileen.sherr@aicpa-cima.com; or me at (408) 924-3508 or annette.nellen@sjsu.edu.

Sincerely,

Annette Nellen, CPA, CGMA, Esq.
Chair, AICPA Tax Executive Committee

Encl.

cc: Mr. Gregory Matson, Executive Director, Multistate Tax Commission
Ms. Helen Hecht, General Counsel, Multistate Tax Commission
Ms. Lila Disque, Deputy General Counsel, Multistate Tax Commission
Mr. Brian Hamer, Hearing Officer, Multistate Tax Commission

AMERICAN INSTITUTE OF CPAs

Comments on the Multistate Tax Commission (MTC) Draft Model Sales and Use Tax Notice and Reporting Statute (Dated April 25, 2018)

June 13, 2018

Background

The Multistate Tax Commission (MTC) Draft Model Sales and Use Tax Notice and Reporting Statute dated April 25, 2018 (Draft Model Statute) was developed based on notice and reporting requirements adopted by Colorado in 2010,[2] as a model for other states to consider in adopting a similar approach for remote vendors that do not collect and remit sales and use tax.

The MTC drafted an earlier version of the Draft Model Statute in 2011. That version was placed on hold when the Direct Marketing Association (DMA) challenged the Colorado law in federal and state litigation, resulting in injunctions against application of the Colorado law. In February 2016, the Colorado law was affirmed as constitutional by the U.S. Court of Appeals for the Tenth Circuit.[3] In February 2017, the parties in the case entered into a settlement, resulting in the removal of the injunctions that prevented enforcement of the notice and reporting requirements. Currently, eleven states have adopted the notice and reporting approach.[4] The Draft Model Statute incorporates concepts contained in the Colorado law, as well as more recent state legislation addressing this issue.

Draft Model Statute

The Draft Model Statute requires remote sellers that do not collect sales and use taxes to:

1. Notify each buyer at the time of a transaction through a prominently displayed notice that the seller is not collecting tax, but the buyer may owe a use tax to the state;

2. Provide each buyer that has $200 or more in transactions:

   A. An annual report of their purchases by January 31 of the following tax year,

   B. A statement that no sales and use tax was collected on these transactions, and

[2] Colorado HB 10-1193, Colo. Rev. Stat. § 39-21-112(3.5).
[3] *Direct Marketing Association v. Brohl*, 575 U.S. ___, 135 S.Ct. 1124 (2015) and *Direct Marketing Association v. Brohl*, Case No. 12-1175 (10th Cir., Feb. 22, 2016).
[4] *See*, *e.g.*, Alabama (Ala. L. 2018 539 § 3), Colorado (Colo. Rev. Stat. § 39-21-112(3.5)), Georgia (GA House Bill 61), Kentucky (Ky. Rev. Stat. Ann. § 139.450), Louisiana (La. Rev. Stat. Ann. § 47:309.1), Oklahoma (Okla. Stat. 68 § 1392), Pennsylvania (Pa. Stat. Ann. 72 § 7213.1), Rhode Island (R.I. Gen. Laws § 44-18.2-3), South Dakota (S.D. Codified Laws § 10-63-2), Vermont (Vt. Stat. Ann. 32 § 9712), and Washington (Wash. Rev. Code § 82.08.053).

C. A statement that the state tax authority will receive a report with the buyer's information; and

3. Send an annual report to the state tax authority by January 31 of the following tax year, showing the total dollar amount of each buyer's purchases.

The notice and reporting requirements broadly apply to remote sellers, as well as marketplace facilitators, referrers, and related parties. In addition, the Draft Model Statute requires a referrer to report the identity of each seller to which it makes referrals.

An exception to the notice and reporting requirements is available for sellers that are registered to collect and remit sales and use tax, and complies in good faith with the state sales and use tax provisions. Also, a *de minimis* exception to the notice and reporting requirements is allowed for a non-collecting seller, marketplace facilitator, and related party that has made less than a certain amount (either $5 million in national gross sales or $100,000 in total in-state transactions) during the prior calendar year.

Penalties are imposed on remote sellers who fail to comply with the notice and reporting requirements. These penalties are imposed on a per transaction basis, and each state is afforded the opportunity to set the penalty rates, which will lead to inconsistent, and potentially onerous penalty amounts for sellers that engage in numerous transactions. In addition, penalties are imposed on referrers who fail to provide a referrer report.

Executive Summary

The MTC and its member states should not adopt the Draft Model Statute for the following reasons:

1. The Draft Model Statute should not require out-of-state businesses that do not have any obligation to collect and remit sales tax to police use tax noncompliance at the businesses' own expense. There are low-cost, comprehensive, and more appropriate techniques for states to assist in-state consumers in meeting their use tax obligations.

2. The Draft Model Statute would likely compel sales and use tax collection by businesses that are not required under *Quill* to collect sales and use tax. Forcing this result through the imposition of a burdensome reporting regime is contrary to good tax policy.

3. The costs of compliance with the Draft Model Statute outweigh the benefits received by the states receiving the reported information.

4. The Draft Model Statute exceeds the conventional principles of sales and use tax, which will lead to further complications and burdens on all parties involved.

<u>Specific Comments</u>

1. **The Draft Model Statute should not require out-of-state businesses that do not collect and remit sales tax to police use tax noncompliance. There are low-cost, comprehensive, and more appropriate techniques for states to assist in-state consumers in meeting their use tax obligations.**

   Through excessive penalties and onerous reporting requirements, the Draft Model Statute essentially places the burden on out-of-state businesses to police purchaser use tax compliance, both for individuals and businesses. While we recognize that states need to address budget issues and ensure that businesses and individuals are meeting their tax obligations, there are other ways to address the problem of low use tax compliance rates.

   <u>More Expansive Informational Efforts</u>

   One approach that the MTC and states can adopt to address low use tax compliance is engaging in a comprehensive effort to inform citizens of their use tax obligations, such as through website postings, mass mailings, radio, television, and social media advertisements, clearer tax form instructions and targeted amnesty programs.

   <u>Use Tax Line on Income Tax Return</u>

   The MTC and more states should also consider the approach that 28 states have already adopted: to insert a line item on individual income tax returns where taxpayers are required to report sales and use tax owed on remote purchases.[5] The implementation of the use tax on the individual income tax return is simple and efficient. It allows states to collect use tax on all sales to individual income taxpayers once a year, including on sales made by vendors located outside of the United States. This method could prove more encompassing than the Draft Model Statute, as the Draft Model Statute includes a *de minimis* threshold, only applies to sales made by United States vendors, and does not require actual payment of the tax.

   However, we do not think expansion of this sales and use tax line option to income or informational returns filed by business entities is warranted. Individuals typically only have one state tax filing to complete each year through the individual income tax return; thus, including a line for sales and use taxes on that filing provides an individual with a convenient opportunity to pay their sales and use tax directly to the state. In contrast, businesses typically are required to complete numerous filings every year, and businesses have regulatory reasons for compliance with the sales and use tax laws. Based on our experience, states do not need to consider expanding the sales and use tax line to business returns. Most businesses are subject

[5] The following 28 states have a line for use tax on the personal income tax return: Alabama, California, Colorado, Connecticut, Idaho, Illinois, Indiana, Kansas, Kentucky, Louisiana, Maine, Massachusetts, Michigan, Mississippi, Nebraska, New Jersey, New York, North Carolina, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Utah, Vermont, Virginia, West Virginia, and Wisconsin. Seven states do not have an income tax: Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming, and residents of New Hampshire and Tennessee only pay tax on dividends and income from investments.

to sales and use tax return compliance obligations and are accountable to their shareholders and stakeholders from a systems reporting perspective (e.g., Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 450 standards with respect to contingencies and disclosing unrecorded liabilities).

Optional Safe Harbor – Look-up Table Approach

Another approach that a state can use to promote use tax compliance through a line item on the individual income tax return is an optional safe harbor (known as the "look-up table" approach).[6] This approach allows the purchasing taxpayer to report a percentage of the taxpayer's adjusted gross income as untaxed purchases in that state in lieu of determining the actual amount of sales and use tax owed. Simplifying the process could assist with compliance in self-reporting tax.

The MTC and states should consider the look-up table approach for the following reasons:

A. It avoids the burden of individuals maintaining records on sales and use tax details, but retains the option for an individual purchaser to rely on actual records instead.

B. The state collects the sales and use tax owed on each large-dollar amount individual purchase. For example, if a single item costs above a certain amount (i.e., $1,000 in California), the purchaser would add the sales and use tax for that item to the table amount.

C. States can establish reasonable estimates in the table based on an individual's adjusted gross income that can provide comfort to the taxpayer and preparer that they have met the use tax filing obligation.

2. The Draft Model Statute would likely compel sales and use tax collection by businesses that are not required under *Quill* to collect sales and use tax. Forcing this result through the imposition of a burdensome reporting regime is contrary to good tax policy.

Good Tax Policy

The notice and reporting requirements of the Draft Model Statute (and states that adopt such an approach) essentially force out-of-state businesses into collecting sales and use tax as an approach for such businesses to opt out of complying with the state's notice and reporting requirements and the potential penalties associated with noncompliance or error.

We recognize that revenue loss associated with sales and use tax noncompliance is a concern for the states. However, as a matter of good tax policy, states should not require out-of-state businesses to report vast amounts of information to in-state consumers and state taxing

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[6] For example, California has a use tax look-up table.

authorities. These requirements, particularly the reporting requirements, obligate out-of-state businesses to perform tasks and expend effort that are more appropriately undertaken by the relevant state tax authorities. It is the state's responsibility to collect sales and use tax. Out-of-state sellers with no physical presence in a state should not have to assist the state and participate in the use tax collection process for the state.

Certainty – *Quill* and Physical Presence

Certainty is important from the perspective of ensuring that states engage in good tax policy. Businesses should have certainty as to their sales and use tax compliance obligations, and to date, the U.S. Supreme Court has spoken to that concern through the adoption of a physical presence test. In *Quill Corp. v. North Dakota*,[7] the U.S. Supreme Court held that states cannot require remote retailers with no physical presence in the state to collect sales and use tax.

Businesses have relied on the certainty of the *Quill* decision since its issuance in 1992. The MTC and states are reducing this level of certainty by applying notice and reporting requirements on businesses that do not have a physical presence in the state.[8] From the perspective of certainty, this is problematic. The Draft Model Statute's requirement to notify and report information at the point of purchase and on an annual basis is more burdensome than the process placed on businesses that collect and remit use tax. This approach places an "undue burden" on out-of-state businesses that is not placed on in-state businesses unless the out-of-state businesses decide to waive the *Quill* physical presence rule.

3. The costs of compliance with the Draft Model Statute outweigh the benefits received by the states receiving the reported information.

In determining whether it is necessary to add a tax provision that will have a significant impact on businesses, engaging in a cost-benefit analysis is often instructive and advised. We do not think that the additional costs of compliance under the Draft Model Statute will result in significant revenue to the states because many state governments do not have the resources to utilize or take advantage of the voluminous information expected from expanded reporting. The marginal benefits that may accrue from collecting this information do not justify the additional costs and burdens to businesses.

[7] *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

[8] The timing of the Draft Model Statute is relevant, in that later this month, the Supreme Court is expected to issue its decision in *South Dakota v. Wayfair Inc., et. al.*, U.S. Supreme Court, No. 17-494. It challenges the *Quill* physical presence rule and could eliminate the need for states to consider notice and reporting requirements as envisioned in the MTC Draft Model Statute. Because many states have economic nexus statutes similar to the provisions adopted by South Dakota, if South Dakota prevails in this case, other states will probably require remote vendors to collect sales and use tax rather than adopt the provisions contained in the MTC Draft Model Statute.

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 Draft Model Statute are significant. It will require businesses to dedicate human and material capital to:

A. Redesign their invoices and systems, purchase orders and sales/lease receipts to display statutorily required boilerplate language. This redesign could, in turn, lead to higher print and administrative costs due to the additional pages and programming required;

B. Reprogram their website pages that replicate invoices, purchase orders and sales receipts to display the same information;

C. 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;

D. Absorb new postage costs, as electronic delivery of purchaser transaction reports requires prior purchaser agreement;

E. Keep track of each state's required method for use tax remittance for each type of customer. The business will need this information to properly inform each customer in the annual reports;

F. Determine the definition of "tangible personal property" in each jurisdiction to properly report transactions to the states. This definition can vary as it relates to software and digital goods.

G. Complete and submit an accurate annual report to the applicable state tax authority, under threat of substantial penalties, listing the total dollar amount by shipping address of all sales of tangible personal property by in-state purchasers, and other information.

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

Benefits

<u>Increased Information Not Likely to Lead to Increased Revenue</u>

We do not think that the Draft Model Statute and the receipt of information on thousands of internet purchases will result in a significant increase in revenue to the states. We are unaware of any data or support that indicates that taxpayers will start, or feel compelled, to report and pay sales and use tax because they receive an annual report or because the seller reported the same information to the state. Given the lack of resources that many state taxing agencies face, it is unlikely that states are equipped to handle collecting, compiling and analyzing the voluminous amount of information that the states will require out-of-state businesses to report.

Total Amount Will Not Provide Taxable Versus Non-Taxable Purchases

Under the provisions of the Draft Model Statute, the states will receive a total amount of sales by taxpayer, without the ability to distinguish between taxable and non-taxable purchases (e.g., sales for resale, medical supplies, prescription eyewear, and clothing). The states will not have detailed information sufficient to determine taxability, which may result in erroneous assessment notices and inefficient use of state auditor resources. This issue is especially true for business-to-business transactions, the taxability of which is often complex and inconsistent from state to state.

Exceptions and Complications

The Draft Model Statute provides an exception from the notice and reporting requirements for "sales with respect to which sales or use tax is not actually due." This exception presents additional problems and complications. For example, in order for the state to have an accurate listing of taxable sales, every reporting entity would need to perform taxability studies for its products in each jurisdiction that adopts the reporting requirements, and each reporting entity would need to determine whether any exemptions apply. This process could also obligate the reporting entity to collect exemption certificates to document exempt sales. Marketplace facilitators would not have access to the information necessary to make these determinations. The complicated process of determining taxability and exemptions will likely result in the state receiving inaccurate information.

4. The Draft Model Statute exceeds the conventional principles of sales and use tax, which will lead to further complications and burdens on all parties involved.

Marketplace Facilitators, Referrers, and Payment Processing

The Draft Model Statute unduly expands on conventional principles of sales and use tax. Sales and use tax is a transactional tax imposed on the sale of certain items by a seller on the use of certain items by a buyer. However, the Draft Model Statute suggests that states place reporting requirements on "marketplace facilitators" and "referrers." In addition, the Draft Model Statute provides that states should consider adding "payment processing" (itself an undefined term) to the definition of a marketplace facilitator.

It is important to note that marketplace facilitators and referrers are not the actual seller or buyer in the transaction. This expansion of the parties involved in sales and use tax compliance, even when couched as a mere notice and reporting requirement, will lead to further complications and burdens for the marketplace facilitators and referrers, as well as for the sellers, buyers, and the state. For example, marketplace facilitators do not have access to the final transaction. Lack of sufficient information could lead to the reporting of incorrect and incomplete filings due to lack of needed details of a transaction and its taxability classification.

Expansion of the law beyond the application of *DMA*, which related to the constitutionality of the Colorado notice and reporting statute, to include marketplace facilitators and referrers could lead these impacted entities to consider pursuing legal challenges. The marketplace facilitator/referrer concepts were not considered in *DMA*, and it is not certain that a court would endorse notice and reporting requirements on these novel types of businesses. In any event, the states will need to address a host of new and complex issues in an already complicated area of taxation. For example:

A. How will a state audit a marketplace facilitator/referrer?

B. What recordkeeping requirements would the state require marketplace facilitators/referrers to follow?

C. Would the state impose responsibility on a marketplace facilitator/referrer for uncollected sales tax?

D. How will a marketplace facilitator/referrer have the requisite knowledge about a sale to correctly charge and remit sales tax? Is it possible that this information gap would result in marketplace facilitators/referrers in a situation where it is not possible to fulfill their sales and use tax obligations?

Conclusion

The AICPA urges the MTC and its member states not to adopt the Draft Model Statute because it is contrary to good tax policy, has many costs and few benefits, will lead to further complications and burdens on customers, sellers, marketplace facilitators and referrers, and the state. Other more effective alternatives exist that properly place the sales and use tax burden on the appropriate party (the in-state buyer).