UPDATE ON E-COMMERCE TAXATION: FOCUS ON EVENTS OF THE PAST YEAR

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Annette Nellen, CPA, Esq.
Graduate Tax Program
San José State University
http://www.cob.sjsu.edu/facstaff/nellen_a/

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WHY TAX ISSUES EXIST

"E-commerce represents a new business model. As such, it creates some challenges to tax systems that were designed with a different model in mind. Two key reasons help explain why e-commerce raises tax issues:

1. Location—Existing tax systems tend to determine tax consequences based on where the taxpayer is physically located. The e-commerce model enables businesses to operate with very few physical locations.
2. Nature of products—E-commerce allows for some types of products, such as newspapers and music CDs, to be delivered in digitized (intangible) form, rather than in tangible form. Digitized products may not be subject to sales tax in some states. Also, the ability to deliver digitized products, as well as services over the Internet also reduces the need for physical locations, thus creating fewer taxing points."[1]

See Appendix A for additional reasons why e-commerce raises tax issues for both taxpayers and taxing authorities.

THE COSTS OF E-COMMERCE TAXATION ISSUES

A. State and Local Government

E-commerce is in its infancy because it represents less than 1% of retail sales. Also, less than 3% of the world's population is on-line. But, the growth potential is great. The Department of Commerce projects that e-commerce will grow to hundreds of billions of dollars annually.

The bulk of dollars in e-commerce likely will continue in the business-to-business arena (currently about 80% of online sales) which presents fewer compliance problems than the business-to-consumer arena. A June 1999 study concluded that 63% of business-to-consumer online sales were non-taxable (such as airline tickets, gambling, and interactive games). Of the remaining 37% of business-to-consumer sales, sales tax was paid on 4% (4% of the 100% of business-to-consumer sales), and 20% was a substitute for other remote sales for which no tax was collected, leaving 13% of total business-consumer sales untaxed. The study applied an average state and local sales tax rate of 6.5% to determine that the estimated sales tax loss was $170 million for 1998, representing one-tenth of 1% of total state and local sales tax collections.[2]

A May 1999 study by Professors Austan Goolsbee and Jonathan Zittrain estimated that for 1998, sales tax loss to state and local governments related to e-commerce sales was less than one-quarter of one percent (about $210

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1 From *Summary of Approaches for Applying Sales & Use Taxes to E-Commerce*, prepared by the Joint Venture Tax Policy Group, March 2000, http://www.jointventure.org/initiatives/tax/taskforce.html.

2 Ernst & Young, *The Sky is Not Falling: Why State and Local Revenues Were Not Significantly Impacted by The Internet in 1998*, June 18, 1999.

million). Assuming a projected 70% per year growth in e-commerce retail sales would yield a revenue loss of under 2% in 2003. The authors of the study note that to keep revenue constant, the average sales tax rate on sales would have to increase only from 6.33% to 6.35% in 1998 and 6.4% in 2003. However, the authors also note that by 2007, the revenue loss would equal about 10% of total sales tax revenue. "It is the possibility of these extreme losses, albeit well into the future, that makes the issue of enforcement so politically sensitive today."[3]

A June 2000 GAO study estimates that the state and local sales and use tax losses for all Internet sales for 2000 is between $0.3 and $3.8 billion (about 2% of projected sales tax revenue). This included both business-to-business and business-to-consumer Internet sales. The projected loss for 2003 is between $1.0 and $12.4 billion (5% of projected sales tax revenue). The differences between the high and low figures is due to varying assumptions as to business-to-business compliance rates and the estimated amount of e-commerce sales.[4]

California: In March 1999, the California Board of Equalization estimated that California's annual loss of sales and use tax from e-commerce was about $18.5 million.[5] Another estimate of sales and use tax losses for California for 1999 from business-to-consumer Internet sales was $66.5 million.[6] The June 2000 GAO study projected sales and use tax losses from all Internet sales for 2000 as between $23 and $533 million. The GAO's projection of lost revenue for 2003 was between $86 and $1,720 million.[7]

Cost of the ITFA Moratorium and its Possible Expansion: The Federal Internet Tax Freedom Act (ITFA, P.L. 105-277, 10/21/98) imposes a 3-year moratorium (from 10/1/98 through 10/21/2001) on state and local taxes on Internet access, unless such tax was generally imposed and actually enforced before October 1, 1998. S. 288 (107th Congress) proposes both to extend the moratorium, and to remove the grandfather provision so that no state or local government could tax Internet access fees. It has been estimated that such a change would cost Texas about $50 million annually and Tennessee about $17 million annually.[8] State Tax Notes estimates that repeal of the grandfather provision would cost the nine states that are covered (California does not tax Internet access) about $90 million in the first year.[9]

A bill similar to S. 288 was passed by the House – H.R. 3709 (106th Congress) in May 2000. The Congressional Budget Office (CBO) released a "mandates statement" explaining that H.R. 3709 posed a problem under the Unfunded Mandates Reform Act. "Because at least one significant state revenue source – taxes on internet access – would clearly be affected and others might be affected, CBO estimates that the extension and expansion of the moratorium would cause revenue losses that would exceed the annual statutory threshold at some point over the five-year period." Due to the difficulty of estimating the potential revenue loss if with the absence of the ITFA, states decided to impose taxes on Internet access, the CBO calculated its estimate using only the states covered by the ITFA's grandfather provision. The CBO also noted: "In addition, by extending the current moratorium, the bill may affect the ability of state and local governments to collect certain other taxes. Significant and continuous change within the industry, as well as uncertainty about possible legal interpretations of these definitions, make it impossible for CBO to predict the likelihood or magnitude of such effects on state and local budgets."[10]

B. Multistate Vendors

Multistate Tax Compliance: A state's ability to impose use tax collection responsibility on a vendor only exists when that vendor has a physical presence in the state. Several years ago, the U.S. Supreme Court found that with

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3 Austan Goolsbee and Jonathan Zittrain, "Evaluating the Costs and Benefits of Taxing Internet Commerce," May 20, 1999. See http://gsbadg.uchicago.edu/internet.htm.

4 GAO, *Sales Taxes – Electronic Commerce Growth Presents Challenges; Revenue Losses Are Uncertain*, GAO/GGD/OCE-00-165, June 2000.

5 California Senate, *E-Commerce - Taxing Internet Sales and Access*, Pub. #99-1, September 1999.

6 Per May 10, 2000 memorandum from Joe Fitz, Chief Ecnomist with the State Board of Equalization to Dean Andal.

7 GAO, *Sales Taxes – Electronic Commerce Growth Presents Challenges; Revenue Losses Are Uncertain*, GAO/GGD/OCE-00-165, June 2000, Table V.1 and Table V.2.

8 Brian Krebs, Newsbytes, *Government Technology*, February 16, 2001.

9 Doug Shepard, "State Revenue Officials: Internet Access Tax Repeal Would Cost #90 Million," *State Tax Notes*, 2001 STT 41-30.

10 CBO Mandates Statement on H.R. 3709, May 8, 2000; ftp://ftp.cbo.gov/20xx/doc2015/hr3709ms.pdf.

6,000+ jurisdictions[11] in the U.S. able to impose sales and use taxes, it would be an impediment to interstate commerce to cause an out-of-state vendor to collect use tax (*Quill* decision (504 U.S. 298 (1992)). For companies that do have collection responsibilities because of being present in most, if not all, of the 46 states imposing a sales tax, compliance costs can be very high. A multistate company will need to hire several individuals to satisfy its compliance obligations, acquire software to assist in the process (which requires at least monthly updates), and to keep up with changes in the law in each state in which it does business. Large companies with many physical locations must budget the resources to comply with all of these tax systems. However, the Internet allows a company to have customers in many different locations while having very few physical locations. It also allows young companies to operate in many states without needing any capital for physical (bricks and mortar) expansion. Such young and small companies would likely be put out of business or not seek the market potential presented by the Internet, if faced with obligations to collect use tax from customers in 6,000+ jurisdictions. Thus, it is unlikely that we will see the *Quill* physical presence standard eliminated by Congress under its Commerce Clause authority without significant simplification of the sales and use tax systems in the 46 states and hundreds of local jurisdictions that impose such taxes.

Complexity also stems from the multitude of changes in state and local sales and use tax systems annually. For example, a provider of sales and use tax compliance software reported 598 instances in which changes were made to sales tax rates or that new sales taxes were added during 1999. This was an increase from 579 such changes in 1998, but less than the 707 changes that occurred in 1994.[12]

The task of reducing the existing complexities for multistate vendors are challenging because in some states, such as Colorado, cities define the tax base, which could (and does) differ from the state tax base. Also, local tax rates are not always bound by zip codes. Instead, some zip codes could include more than one local tax rate. In addition, definitions of items differs from state to state, as do exemptions from the tax. In addition, tax forms and due dates, as well as audit procedures vary from state to state.[13]

Costs of Tax Compliance Can be High: The costs to comply with the tax rules of multiple domestic and foreign taxing jurisdictions can be quite high in terms of labor costs, training, computer systems, need for continual updates due changes in laws and regulations, audits, credit card fees, and risk of error. A recent study by the State of Washington on sales tax compliance costs reached the following conclusions:[14]

Costs as a percent of total state and local sales tax collections:

Small business	6.47%	(gross sales between $150,000 and $400,000)
Medium business	3.35%	(gross sales between $400,000 and $1,500,000)
Large business	0.97%	(gross sales over $1,500,000)
Total cost weighted by number	4.23%	
Total cost weighted by dollars	1.42%	

The costs of compliance can also be complicated and costly due to the frequent changes to tax rules and forms. While many companies rely on software systems for compliance, such systems can be expensive to obtain and maintain. Also, many large companies may find that they need to create their own software systems rather than purchase canned programs.

A 1999 study by Ernst & Young LLP concluded that the costs of administering state and local sales taxes were primarily borne by vendors. The report notes that a large remote seller in 15 states has compliance costs of about 8.3% of the sales and use taxes paid. It was also noted that e-commerce vendors would face additional costs over

11 While there are over 6,000 jurisdictions that can assess a sales tax, the rules of most local jurisdictions are the same as the state in which they are located. Thus, there are not over 6,000 sets of sales and use tax rules.

12 Information provided by Vertex, Inc.; www.vertexinc.com/taxcybrary20/salestax_chronicle/taxfacts_main.asp.

13 For further discussion of sales and use tax complexities, see Joint Venture's Internet Taxation Briefing Paper 2000-4 at http://www.jointventure.org/initiatives/tax/tax_brief4.html.

14 Washington State Department of Revenue, *Retailers' Cost of Collecting and Remitting Sales Tax*, December 1998; http://www.wa.gov/dor/reports/retail/retailsum.htm. The report also notes that the costs of collection can be offset somewhat by the float that retailers enjoy due to the lag between collection and remittance of the tax, and the ability to deduct these costs on their income tax returns.

traditional vendors. For example, there would be added costs of collecting information about the buyer's location.[15]

Burden can be high as well: It is not just companies trying to minimize costs that may tend to limit having a physical presence in many states or to not voluntarily collect use tax. At least one government organization also does not voluntarily collect use tax on sales of goods even though it knows that local governments need the revenue. The author of this outline purchased books from the National League of Cities (NLC) located in Maryland in 1998 and was not charged sales tax (the author voluntarily paid the use tax on her own though). Presumably, the NLC doesn't voluntarily collect use tax due to the cost and burden of doing so.

Lead time: Any change to existing tax systems will most likely need to factor in a time for companies to modify their tax and accounting systems. A recent example of the difficulty posed by what may seem like a trivial change is the reduction in the federal mileage rate from 32.5¢ per mile to 31¢ per mile. The IRS announced that this change would be effective January 1, 1999, but had to postpone it to April 1, 1999 because of complaints from companies that they would not be able to modify their payroll and other systems in time to comply.[16]

THE FEDERAL ADVISORY COMMISSION ON ELECTRONIC COMMERCE (ACEC)

A. Brief Background

In addition to establishing a 3-year moratorium on specified state and local taxes, the Internet Tax Freedom Act also called for formation of a 19-member Advisory Commission on Electronic Commerce (ACEC). The members included 8 representatives of state and local governments (including one from a state with no sales tax and one from a state with no income tax), and 8 representatives from the e-commerce industry (including small business), telecommunications carriers, local retail businesses, and consumer groups. The ACEC was to conduct a thorough study of all levels of tax with respect to e-commerce, including considerations of all types of remote commerce, and report to Congress in April 2000. The ACEC report could contain legislative recommendations. Per the legislation that established the ACEC, "any recommendation agreed to by the Commission shall be tax and technologically neutral and apply to all forms of remote commerce. No finding or recommendation shall be included in the report unless agreed to by at least two-thirds of the members of the Commission serving at the time the finding or recommendation is made."

In April 2000, the ACEC issued a report describing proposals of the majority. The ACEC was unable to reach the required 2/3 vote to come up with recommendations on most matters. The report did not include the views of the minority.

B. Majority Proposals of the Advisory Commission on Electronic Commerce

Despite failure to achieve the required 2/3 majority consensus on any position on how to apply sales and use taxes to electronic commerce transactions, the ACEC did include in its report to Congress a proposal that received 11 positive votes (out of 19 votes). The report of the minority was not included in this report. The key elements of the sales tax and internet access tax proposals included in the ACEC's report to Congress are described below.

1. Extend and expand the moratorium—The majority of ACEC members advocate that the ITFA moratorium be extended an additional five years. In addition, it should be broadened to also prohibit taxation of digitized goods and their non-digitized counterparts. Thus, for five years, no state or local governments would be allowed to collect sales tax on any sale of software, periodicals, books, videos, and any other items that can be digitized.

2. Provide a federal level definition of nexus—The majority proposed that the following factors would not cause a seller to have sufficient nexus for sales tax collection purposes: "(a) a seller's use of an Internet service provider ("ISP") that has physical presence in a state; (b) the placement of a seller's digital data on a server located in that particular state; (c) a seller's use of telecommunications services provided by a telecommunications provider that has physical presence in that state; (d) a seller's ownership of intangible

15 Robert J. Cline and Thomas S. Neubig, *Masters of Complexity and Bearers of Great Burden: The Sales Tax System and Compliance Costs for Multistate Vendors*, September 1999; http://www.ey.com/global/vault.nsf/us/masters_of_complexity/$file/complexity.pdf.

16 Alejandro Bodipo-Memba, "IRS Postpones Effective Date for Cut In Tax Deduction for Business Driving," *Wall Street Journal*, 12/29/98, page A2; Rev. Proc. 98-63; and IRS Announcement 99-7.

property that is used or is present in that state; (e) the presence of a seller's customers in a state; (f) a seller's affiliation with another taxpayer that has physical presence in that state; (g) the performance of repair or warranty services with respect to property sold by a seller that does not otherwise have physical presence in that state; (h) a contractual relationship between a seller and another party located within that state that permits goods or products purchased through the seller's web site or catalogue to be returned to the other party's physical location within that state; and (i) the advertisement of a seller's business location, telephone number, and web site address."

3. Work towards a uniform sales tax law—The majority encourages state and local governments to work with an existing organization involved in drafting uniform laws for the states to adopt[17] in order to create a uniform sales and use tax act. This uniform act should cover tax base definitions, sourcing rules, audit procedures, and administration. In addition, the majority recommended that a new advisory commission be formed to oversee the work towards a uniform RST act.
4. No taxes on Internet access charges—A majority of commissioners (11) proposed that the current moratorium on any transaction taxes on Internet access fees be made permanent including for the taxes grandfathered under the ITFA.

C. ACEC Minority Report—Five of the eight Commissioners representing government released a report on their own.[18] This report explains the minority's concerns with the majority report, lists several principles that should guide reform and lays out a proposal for state and local governments to address issues of applying sales and use taxes to e-commerce.

1. Concerns with majority report—The minority's concerns with the proposal of the majority is that it would create special "tax privileges" for e-commerce businesses leading to a $20 billion annual shift of taxes to main street businesses and individuals. They also suggest that the majority report is not "tax and technologically neutral" as required by the ITFA because it favors e-commerce businesses. The minority report also states that the majority proposal would undermine state sovereignty by limiting state and local taxing authority and limit the ability to provide local services.
2. Principles of applying sales tax to e-commerce—The principles laid out in the minority report include:
   a. There must be a "level-playing" field where all sellers are treated similarly regardless of their form of distribution.
   b. There must be "radical" simplification of the sales tax.
   c. The Internet should not be a "target" for new taxes.
   d. The demand for services of state and local governments will not decline in the future and any changes to the tax system must recognize this.
   e. There is no need for the federal government to restrict state and local taxing authority.
   f. Changes in the telecommunications industry necessitate updating existing taxes imposed on this industry.
   g. Tax policy must not compromise privacy rights on the Internet.
3. Minority sales and use tax proposal—The minority suggests a "streamlined and fair" tax system, which would include the following elements:
   a. The moratorium against Internet access taxes and multiple and discriminatory taxes would be extended until simplification efforts are completed.
   b. Give the states until the end of 2003 to radically simplify the sales tax. State and local governments should work with the National Conference of Commissioners on Uniform State Laws (NCCUSL) to create a "streamlined sales and use tax system." The features of such a system should include centralized registration, uniform definitions of the tax base, uniform sourcing rules, uniform exemption administration rules, protection of consumer privacy, certification method for software to be used for compliance, uniform returns, and uniform audit procedures. In addition, Congress should adopt

[17] National Conference of Commissioners of Uniform State Laws (NCCUSL).

[18] The report was issued by Commissioners Jones, Leavitt, Lebrun, Kirk, and Locke. The report can be found at Tax Analysts' database, 2000 STT 70-29.

legislation to provide that states adopting the streamlined sales tax system will be allowed to collect use tax from remote sellers, although a de minimis rule would exist.

c. Congress should not legislatively define nexus (as suggested by the majority) because doing so focuses too much on physical activity which is not an important factor for e-commerce. Also, under the streamlined sales tax system, it would be simpler to determine tax collection obligations based on a seller's sales volume in the state. In the meantime, states should try to clarify nexus guidelines and have a procedure to enable sellers to determine if they have nexus in the particular state.

d. Telecommunications taxes should be simplified and modified to better address deregulation and other changes in the industry. Consideration should be given to phasing out the 3% federal telecommunications excise tax, if it makes sense given existing federal revenue needs. (A majority of commissioners (11) also proposed to eliminate the 3% federal excise tax on communications services.)

e. Citizens should be kept informed on various proposals and their likely impact to state and local revenues. In addition, revenue neutrality should be a goal.

f. By the end of 2003, the states should develop a uniform and simple system to tax digital products and services that does not violate individual privacy rights or create a compliance burden.

ACTIVITIES OF THE 106TH CONGRESS

A variety of proposals were introduced in the 106th Congress:

1. Extend and/or expand the ITFA moratorium—Some proposals called for extending the existing moratorium for two to five years, while others called for making it permanent. Some proposals also called for removal of the grandfather provision so that no state or local government will be able to tax Internet access fees. Some proposals would have broadened the moratorium to also prohibit sales and use tax on items purchased via the Internet. In May 2000, the U.S. House of Representatives passed H.R. 3709 (352 - 75) to extend the moratorium through October 21, 2006, repeal the grandfather provision that let some states tax Internet access, and encourage states to develop uniform sales and use tax rules.[19]

2. Creation of federal nexus standards—At least two legislative proposals called for creation of a set of factors to be used to determine if a business has nexus in a state for sales tax purposes. The factors are similar to those suggested in the ACEC report (discussed above).[20]

3. Federal level tax—S. 1433, the Sales Tax Safety Net and Teacher Funding Act, would impose a 5% "retail excise tax on merchandise sold via the Internet, through catalogs, or sold other than through local merchants in order to supplement the funding for elementary and secondary school teacher salaries." A credit would be allowed for state and local sales taxes paid by the buyer. The tax would go into a trust fund to be distributed to the 50 states and the District of Columbia for teacher salaries.

ACTIVITIES OF THE 2000 CALIFORNIA LEGISLATURE

A review of Internet taxation bills introduced in the prior session of the California legislature may shed some light on what may be reintroduced in 2001/2002. AB 2412 (described below) has already been reintroduced as AB 81 (Migden). Also, there may be some discussion of the Streamlined Sales Tax Project (described later) and extension of the California Internet Tax Freedom Act that expires in 2001.

AJR 41 (Pacheco) – resolves that the President and 106th Congress should act favorably on legislation to make the Internet Tax Freedom Act moratorium permanent. AJR 41 makes reference to S. 1611 as an example for making the ITFA permanent. However, S. 1611 does more than make the current moratorium permanent, it would also expand it to include sales and use taxes on domestic or foreign goods or services acquired through e-commerce. AJR 41 also

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19 The following proposals of the 106th Congress called for extending and/or expanding the ITFA moratorium: S. 328, S. 1611, S. 2028, S. 2036, S. 2255, H.R. 3252, H.R. 3709, and H.R. 4460. For further information on these proposals, see thomas.loc.gov.

20 The following proposals of the 106th Congress called for creation of sales tax nexus guidelines at the federal level: S. 2401, and H.R. 4267. For further information on these proposals, see thomas.loc.gov.

supports a permanent global ban on tariffs on e-commerce and special or multiple taxes on e-commerce and the Internet.

SB 1377 (Haynes) – would add a sales and use tax exemption for any tangible personal property ordered over the Internet. Despite R&T Section 2230, there would be no state reimbursement to counties and cities for revenue losses caused by this proposed new exemption.

SB 1556 (Brulte) – would create a sales tax exemption for tangible personal property used to provide broadband services for use by certain persons in conducting an Internet service business, or to upgrade cable TV facilities for the provision of advanced digital communications services, or similar services The exemption would not apply for local sales and use taxes.

SB 1933 (Vasconcellos) – calls for formation of a temporary commission - the California Commission on Tax Policy in the New Economy, to examine the impact of the Internet and e-commerce on sales and use taxes, income taxes, telecommunication taxes and other taxes. In addition to nine voting members representing local government, academia, the private sector, and public interest groups, there would be non-voting members from various tax agencies and the legislature. The commission can establish technical assistance groups and is to hold public hearings. The commission is to make recommendations and issue a preliminary report within 12 months of its first meeting and a final report within 24 months.

> Status: Governor Davis signed this bill in September 2000 (Chapter 619, 9/24/00). In vetoing AB 2412 (discussed later), Davis noted that the subject matter of AB 2412 warranted review, such as through the California Commission on Tax Policy in the New Economy, to be formed under SB 1933.

SB 1949 (Costa and Chesbro) – would direct the Governor to enter into discussions with other states "regarding the development of a multistate, voluntary, streamlined system for sales and use tax collection and administration."

> Status: Governor Davis vetoed this bill on September 25, 2000 because he deemed it unnecessary. He noted that California already participates in such forums as the Multistate Tax Commission and National Governor's Association that work on tax simplification activities.

AB 1784 (Lempert, Honda and Cunneen) – would extend the California Internet Tax Freedom Act for three more years (through December 31, 2004).

> Status: Governor Davis signed this bill on September 25, 2000. However, it will not take effect because he did not also sign AB 2412 (see later discussion). The bills had been "tied together" when sent to the Governor.

AB 2188 (Baldwin) - would add a use tax exemption for any tangible personal property purchased from a retailer not engaged in business in California provided the purchaser is not a seller or retailer. Despite R&T Section 2230, there would be no state reimbursement to counties and cities for revenue losses caused by this proposed new exemption.

AB 2367 (Leonard) – would reduce the state sales and use tax rate by .25% annually until it reaches a specified level. It would not reduce the tax for local sales and use taxes or transactions and use taxes. "It is the intent of this act to phase out the current California state share of sales and use taxes in order to make the total taxes paid by consumers at California retail stores closer to the price of a purchase on the Internet."

AB 2412 (Migden and Aroner) – would clarify the sales and use tax rules to provide that a retailer is responsible to collect sales tax if engaged in business in the state who processes orders electronically (by fax, via Internet, etc.). AB 2412 would also "prospectively clarify" that "a retailer is presumed to have an agent within the state," if it meets both of the following conditions. "(A) The retailer holds a substantial ownership interest, directly or through a subsidiary, in a retailer maintaining sales locations in California or is owned in whole or in substantial part by such a retailer, or by a parent or subsidiary thereof; and (B) The retailer sells the same or substantially similar line of products as the retailer maintaining sales locations in California under the same or substantially similar business name, or facilities or employees of the related retailer located in this state are used to advertise or promote sales by the retailer to California purchasers". Thus, a company with an affiliate, subsidiary or related entity in the state would have the same nexus as the related entity if they sell the same type of products and there is a substantial ownership interest. A substantial ownership interest is defined by reference to federal law under Title 15, §78p (federal securities law) which refers to an ownership level in excess of 10%.

Commentary on AB 2412

The apparent goal is to address the sponsors' concern that some bricks and mortar stores have established separate legal entities for their e-commerce activities which do not have a physical presence in California and are therefore not required to collect sales tax from customers. However, case law supports the view that a separate legal entity does not have nexus of a related entity attributed to it. For example, in *Current, Inc. v. SBE*, 24 Cal. App 4th 382, 29 Cal Rptr.2d 407 (Ct. Appeal 1994), the court held that a remote seller could not be treated as having nexus due to the physical presence of a parent corporation where the corporations were separate and distinct entities, did not have integrated operations and did not act as the alter ego or agent of the other for any purpose. The court noted that in similar cases, courts have "relied upon the fundamental principle of corporate law that the parent corporation and its subsidiary are to be treated as separate and distinct legal persons in the absence of a showing that corporate assets have been intermingled, that the formalities of separate corporate procedure have been ignored, or where the corporation is inadequately financed."

In the *Current* case, the court found that R&T §6203(g) (as it existed then) was unconstitutional under the commerce clause. This provision imposed a tax collection responsibility upon "any retailer owned or controlled by the same interests which own or control any retailer engaged in business in the same or similar line of business in this state." The language found to be unconstitutional in the *Current* case is quite similar to the proposed language of AB 2412.

Similarly, see *SFA Folio Collections, Inc. v. Bannon*, 585 A.2d 666 (Conn. 1991), cert. denied, 501 U.S. 1223 (1991), *SFA Folio Collections v. Tracy*, 652 N.E.2d 693 (SCt Ohio 1995), and *Bloomingdale's v. Dept. of Revenue*, 567 A.2d 773 (1989), aff'd without opinion 591 A.2d 1047 (Penn. 1991), cert. denied, 504 U.S. 955 (1992).

In *Bloomingdale's*, *supra*, Pennsylvania tried to get Bloomingdale's By Mail, Ltd. (By Mail) to collect use tax from catalog sales delivered into the state. By Mail was formed as a wholly-owned subsidiary of Federated Department Stores, Inc. Federated is a Delaware corporation with headquarters in Ohio and with stores (Bloomingdale's) in Pennsylvania. By Mail is a New York corporation with officers and directors in New York, Ohio, and Connecticut. It operates its nationwide mail order business from Virginia and a fulfillment center in Connecticut. Customer orders are received at one of these locations and shipped to the customer by U.S. mail or common carrier. By Mail customers may pay by various credit cards including a Bloomingdale's card. Customers wanting to return merchandise, do so to By Mail. By Mail had customers in Pennsylvania but did not collect use tax from them because By Mail did not have a physical presence in that state.

The Pennsylvania Department of Revenue argued that By Mail had sufficient nexus with the state to enable the state to impose use tax collection obligations. State arguments included: i) there were at least two instances where By Mail customers were allowed to return merchandise to a Bloomingdale's department store, ii) By Mail and Bloomingdale's use the same advertising themes and motifs, and iii) By Mail's separate corporate existence from Bloomingdale's department stores is a mere legal formality which should not control constitutional considerations, but should be treated as an agency relationship, such as in *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960). The court discredited each of these arguments as follows: i) the two merchandise returns were "aberrations from normal practice," ii) similar advertising themes is not enough to constitute nexus, and iii) By Mail does not have agents acting on its behalf in Pennsylvania, as Scripto did by using independent contractors to solicit sales for the company.

In contrast, in *The Reader's Digest Association, Inc. v. Mahin*, 255 N.E.2d 458 (S Ct Ill 1970), cert denied 399 U.S. 919 (1970), the presence of subsidiaries in Illinois was attributed to the parent corporation. One of the subsidiaries solicited advertising for the parent corporation's magazine, thus acting as the parent's agent.

The difference between the approach of AB 2412 and existing law is that AB 2412 would label two corporations as being in an agency relationship without looking at what the one does for the other to indicate an agency relationship. Ownership and similar business activities do not create an agency relationship. In the *Reader's Digest* case, the subsidiary solicited advertising on behalf of the parent corporation, creating an agency relationship. In the other cases cited above, the situation was similar to that laid out in AB 2412 and attribution of one corporation's presence to another corporation was found to be unconstitutional. Rather than describing an agency relationship, AB 2412 seems to be taking the approach that two legal entities are deemed to be just one entity if a substantial ownership relationship exists and they sell the same products or assist in advertising. This ignores many years of case law that treat separate legal entities as separate taxpayers unless there is a basis for piercing the corporate veil due to insufficient financing or independence.

This bill would attempt to have Borders.com and BarnesandNoble.com collect California sales tax, but would have no impact on Amazon.com. Thus, consumers could buy books from Amazon without a sales tax charge, but not from the other two booksellers (although Amazon customers are technically required to self assess use tax).

Supporters of the bill included many local governments, the California League of Cities, the California Teachers Association and a few independent bookstores. Opposition to the bill came from a much smaller list consisting of the Silicon Valley Software Industry Coalition and Dean Andal, Chair of the State Board of Equalization. In a letter from Dean Andal to Senator John Burton dated June 15, 2000, urging defeat of AB 2412, Dean Andal also noted another constitutional issue with AB 2412: "Since the bill would be an expansion of existing tax law, it should have received more than 53 votes in the Assembly to pass. Passage of the bill with only a majority vote violated the two-thirds legislative vote requirement of Article XIII A, Section 3 of the California Constitution." Mr. Andal's letter includes a copy of a letter from Timothy W. Boyer, Chief Counsel of the SBE stating that he does not view AB 2412 as just clarifying existing law.

Status: AB 2412 was passed in the Assembly on May 30, 2000 and in the Senate on August 30. Governor Davis vetoed the bill on September 25, 2000. Governor Davis stated, "In order for the Internet to reach its full potential as a marketing medium and job creator it must be given time to mature. At present, it is less than 10 years old. Imposing sales taxes on Internet transactions at this point in its young life would send the wrong signal about California's international role as the incubator of the dot-com community. … AB 2412 singles out companies that are conducting transactions electronically and attempts to impose tax collection obligations on them to which, according to California courts, they are not subject." [Office of the Governor, press release of 9/25/00]

Despite the implication from Governor Davis that AB 2412 imposes a new tax, the bill attempts to get certain Internet retailers to collect sales tax that should instead be a self-assessed use tax of customers.

ACA 28 (Runner) – "This measure would prohibit the state and its political subdivisions from levying or collecting, as defined, a bandwidth tax, a bit tax, an electronic messaging tax, a tax upon, or a franchise fee with respect to the provision of, access to or the use of the Internet or online computer services, a sales or transactions and use tax upon a certain type of transaction involving an "off-site" electronic customer, or a sales or transactions and use tax at a rate in excess of total applicable sales or transactions and use tax rates as of a certain date."

To obtain the full text and status of the above bills, search for the particular bill at:

http://www.leginfo.ca.gov/bilinfo.html

STREAMLINED SALES TAX PROJECT [http://www.geocities.com/streamlined2000/]

Overview

The Streamlined Sales Tax Project (SSTP) stems from the simplification suggestions made in the minority report of the federal Advisory Commission on E-Commerce (formed by the Internet Tax Freedom Act) and suggestions of the National Governors Association (NGA) in 1999. A group of representatives from over 35 states met throughout 2000 to create a Model Act and Agreement for a uniform sales and use tax act. The language was approved by the participating states in December 2000. While some additional work is needed to fill in some missing pieces, many states will review the Model Act and Agreement to see if they want to adopt the uniform rules. A few states, such as Kansas, have already introduced legislation, and one state – Wyoming, has already enacted legislation. In addition, multistate vendors will also review the SSTP proposal to understand what it might mean for them should states in which they have customers (whether or not the vendor has nexus (taxable presence) in the state) adopt the SSTP proposal.

- Mission: "The Streamlined Sales Tax Project will develop measures to design, test and implement a sales and use tax system that radically simplifies sales and use taxes." [http://www.geocities.com/streamlined2000/oprules.html]
- Developed by 30 participating states and 9 observer states with input from local governments and businesses.
- Focused on simplification for all types of vendors.
- Provides rules on the following in order to improve administration of the sales and use tax:

"a. State level administration of sales and use tax collections.

b. Uniformity in the state and local tax bases.

c. Central, electronic registration system for all member states.

d. Simplification of state and local tax rates.

e. Uniform sourcing rules for all taxable transactions.

f. Uniform definitions within tax bases.

g. Simplified administration of exemptions.

h. Simplified tax returns.

i. Uniform rules for deductions of bad debts.

j. Simplification of tax remittances.

h. Protection of consumer privacy."

• Specifies three models for collection:

Model 1 Seller—Uses a CSP (Certified Service Provider) as its agent to perform all sales and use tax functions. However, Seller is responsible for remitting tax on its own purchases.

Model 2 Seller—Uses a CAS (Certified Automated System) to perform its sales and use tax functions. However, Seller is responsible for remitting tax on its own purchases.

Model 3 Seller—Has sales in at least 5 member states, total annual sales of at least $500 million, has a proprietary system to calculate tax due in each jurisdiction, and has entered into a performance agreement with the member states.

Note: The Agreement implies that other types of sellers exist, such as a "Main Street retailers," who would likely just handle their own sales/use tax compliance, just as they do today.

• States are to pay for the system design – vendors will still have some collection costs, particularly Model 2 and 3 Sellers.

A pilot project has been approved for Model 1 sellers. A tax software vendor – esalestax.com, is testing a pilot project in Kansas, Michigan, North Carolina and Wisconsin. There is no cost to vendors who sign up to participate and many aspects of their compliance burdens will be taken over by esalestax.com. For information, see http://www.esalestax.com/pilot.htm.

• Uniform definitions of items relevant for determination of a member state's tax base are provided for clothing, clothing accessories or equipment, sport or recreational equipment, protective equipment, food and food ingredients, candy, dietary supplement, soft drinks, food sold through vending machines, prepared food, and sales price.

To give an example of the detail of these definitions, an analysis of "food" follows. The Model Agreement provides that "food and food ingredients" means "substances, whether in liquid, concentrated, solid, frozen, dried, or dehydrated form, that are sold for ingestion or chewing by humans and are consumed for their taste or nutritional value." "Food and food ingredients" does not include alcoholic beverages or tobacco. The Model Agreement's definition of "candy" is "a preparation of sugar, honey, or other natural or artificial sweeteners in combination with chocolate, fruits, nuts, or other ingredients or flavorings in the form of bars, drops, or pieces. Candy shall not include any preparation containing flour and shall require no refrigeration." Candy can be excluded from the definition of "food and food ingredients." Thus, a member state would be able treat "food and food ingredients" as exempt from sales tax, but tax "candy." Or, both could be subject to tax or exempt. In addition, with "food sold through vending machines" defined separately, "candy" sold via a vending machine could be exempt while "candy" sold via other means could be taxable. There are various combinations possible, provided the member states uses the model uniform definitions. "Soft drinks" are also separately defined from "food" and thus, would have the same tax options as "candy."

"Sales price" is defined to include seller costs of the property or services sold plus delivery and installation charges.

<u>Query</u>: Will states agree with the uniform definitions? To the extent the uniform definitions don't match definitions currently used by a state and the state currently has some exemptions within the uniform definitions, it will likely find that use of the uniform definitions will be a revenue raiser or loser. For example, some states today do not apply sales tax to delivery or installation charges (for example, California does not tax these items per R&T §6011). Under the Model Agreement, such charges would become taxable, thereby increasing the tax base. Query whether it is simpler to have a uniform definition of sales price that includes delivery and installation charges rather than leaving such charges as separate (as with "candy" and "soft drinks") as it may

not be difficult to separately charge for installation and delivery and exempt them from taxes in states employing such a rule.

- The Model Agreement does not include a definition for "tangible personal property," a term that is quite important in most states, including California. Under California law, sales tax is imposed on retailers for the privilege of selling tangible personal property. California R&T §6016, defines "tangible personal property" as "personal property which may be seen, weighed, measured, felt, or touched, or which is in any other manner perceptible to the senses." It is likely the SSTP is still working on a definition of "tangible personal property." One important aspect of the definition is whether it includes digital products, such as software transferred electronically, because some states currently treat such items as tangible and others (such as California) do not.

- Tax Rates – One Rate or Multiple Rates: The SSTP proposal does not require one-rate-per-state. Whether Congress will view such omission as sufficient simplification to warrant allowing member states to impose sales tax collection obligations on remote sellers is a debate that will occur as more serious discussion takes place in Congress and the States.

  Analysis: Various proposals have called for simplification to include one-rate-per-state. Examples of such proposals include:

  - Senator Bumpers' Consumer and Main Street Protection Act of 1997 (S. 1586, 105th Congress) basically called for one-rate-per-state for remote sales.

  - The NGA's proposal "EC-12. Streamlining State Sales Tax Systems" (adopted Winter 1999) called for one-rate-per-state for remote sales and a requirement that states "establish a method of distributing to local governments their appropriate share of such taxes."

  - S. 288 (Wyden, 107th Congress) calls for one-rate-per-state for all sales transactions.

  - S. 512 (Dorgan, 107th Congress) calls for one-rate-per-state only for remote sales transactions.

  Some of the issues surrounding a one-rate-per-state system include:

  a. Should the one-rate-per-state apply only for remote sale or for all sales? Arguably, the simplification argument only applies to multistate vendors operating remotely in some states. That is, a Main Street retailer with a store in San Jose (8% rate) and another in San Luis Obispo (7% rate) can easily charge these differing rates in each store. On the other hand, a remote vendor with no physical location in California and selling to individuals in all counties, would face a wider range of rates and, unlike the Main Street retailer, would have to find out from each customer where they live so the proper tax rate could be determined.

     However, if one-rate-per-state only applies to "remote vendors" it remains necessary to have nexus guidelines to assist in determining if a vendor is "remote" or "physically present." This is an issue that results in a fair amount of litigation and confusion.

  b. How should a state, such as California with multiple rates, determine what its "one-rate" would be? While a weighted average rate might be determinable that would be revenue neutral looking at all cities and counties as a whole, there would be winners and losers among local jurisdictions in their sales tax collections.

  c. Neutrality would not be achieved if "one-rate" only applied to remote vendors. That is, if the tax rate applied by the computer vendor in town is 8.25% and the rate from the remote computer vendor is the state's "one-rate" of 7.25%, a buyer might find it to be a better deal to buy from the remote vendor. Under a neutral tax system, the tax cost should not play a part in this decision as to where to buy a product. Of course, tax principles, such as neutrality, must be weighed against other tax principles, such as simplicity, because it is not always possible to achieve all tax principles that make for an ideal tax system. Some local governments will also have to consider that while one-rate-per-state on remote sales may not generate sales tax at the local jurisdiction's higher established rate, it can though, lead to sales tax collections that otherwise would not have occurred (because use tax compliance, particularly among individual consumers, is almost non-existent).

- The Model Agreement is not effective until adopted by at least five states.

Following approval of the draft Agreement and Act in December 2000 by the states participating in the SSTP, the National Governors Association (NGA) expressed its continued support of the project. In January 2001, the National

Conference of State Legislatures (NCSL) voted to approve the SSTP, but with significant amendments. For example, the NCSL removed the uniform definitions. Appendix B to this outline notes the changes made by the NCSL.

Appendix B also compares the simplification proposals of the SSTP to those suggested in S. 288 and S. 512 for a simplified sales and use tax system for remote sales. S. 288 (107th Congress) is Senator Wyden's proposal to extend the federal moratorium of the Internet Tax Freedom Act (ITFA) and to suggest features that must exist for the sales tax to be simplified enough to allow participating states to obtain Congressional approval to collect sales and use tax from remote (non-present) vendors. S. 512 (107th Congress) is Senator Dorgan's bill to extend the ITFA moratorium and state the features of a streamlined sales and use tax system. Appendix B highlights areas where Congress and the states may be in disagreement over what constitutes a simplified sales and use tax system.

California and the SSTP

SB 1949 was introduced in February 2000 by Senators Costa and Chesbro. This bill would have directed the Governor to enter into discussions with other states "regarding the development of a multistate, voluntary, streamlined system for sales and use tax collection and administration." SB 1949 was passed in both the California Assembly and Senate, but was vetoed by Governor Davis in September 2000 because he deemed it unnecessary. He noted that California already participates in such forums as the Multistate Tax Commission and National Governor's Association that work on tax simplification activities. It is certainly possible, given the fact that the Legislature supported streamlined sales tax efforts, that legislation related to work of the SSTP could be reintroduced in California. In addition, as noted by Governor Davis, simplification work of the MTC and NGA (an organization that supports the SSTP) could lead California to consider all or part of the SSTP proposal.

Considerations for Local Governments

- How much of the administrative costs of the SSTP approach would the states pass along to local jurisdictions?
- Today, the city's share of the sales tax (1¢) is sourced under the origin principle (where the sales office is located, rather than where the product was shipped to). This is different than provided for in the Model Act. Could cities continue to use the origin approach, or would they also have to adopt the sourcing rule of the Model Act? What would be the revenue effect to cities if the sourcing rule were changed (there would be winners and losers)?
- S. 288 calls for one-rate-per state (the SSTP does not). Today, there are 8 different sales tax rates used in California. While one-rate per state would make collection easier for remote vendors, it would be difficult to achieve – there would be winners and losers. Also, the highest rate cannot just be adopted because revenue neutrality would not be achieved.
- Should efforts be made to redefine the tax base in California using the uniform definitions? Should intangibles be subject to tax (such as digitized products)?

THE 107TH CONGRESS

S. 777 (Allen) – would permanently extend the ITFA moratorium and remove the grandfather provision so that no state or local government could impose taxes on Internet access.

S. 664 (Gregg) - the "New Economy Tax Fairness Act" or NET FAIR Act provides that no state may assert any business activity tax or impose sales and use tax collection obligations on a vendor that does not have a "substantial physical presence" in the State. The bill provides a list of activities which do not constitute a substantial physical presence. The list of "protected" activities includes solicitation of orders by the vendor or the vendor's representative for the sale of tangible or intangible personal property or services if the orders are approved or rejected outside of the state and approved orders are filled by delivery from a point outside of the State, presence or use of intangibles (such as trademarks or electronic signals or web pages) in the state, use of a web site, and use of an unaffiliated contractor in the state to perform warranty or repair work on property sold by a vendor located outside of the State. The "protections" do not apply to a vendor incorporated in the state or any individual domiciled or a resident of the State. An agency relationship may constitute a "substantial physical presence" in the State. An agency relationship only exists if it "(1) results from the consent by both persons that one person act on behalf and subject to the control of the other; and (2) relates to the activities of the person within the State." The provision is effective upon enactment and so will not invalidate collection of any business activity tax imposed prior to that date (even though it violates one of the "protections'). If a vendor terminates its "substantial physical presence" in the State, the State can no longer after that point impose an obligation to pay a business activity tax or to collect and remit a sales or use tax upon the vendor. S. 664 is identical to S. 2401 introduced by Senator Gregg in the 106th Congress.

Senator Gregg notes: "NET FAIR provides legal certainty for companies and consumers that engage in interstate commerce via the Internet, telephone, or mail order. This bill adheres to our Founding Fathers' tenet of 'no taxation without representation' by codifying fair taxation principles. We cannot stand idly by and allow this new economic avenue to be hampered with new taxes. This legislation does not preempt a State's right to tax commerce; however, it does protect businesses and consumers from unfair taxation on interstate commerce and from what could be a crippling effect on the growth of the new 21st Century economy." [Congressional Record of 3/29/01, S3172]

S. 589 (Smith) - would make the Internet Tax Freedom Act moratorium permanent, but keep the grandfather provision which allows states to impose taxes on Internet access if such taxes were generally imposed and actually enforced prior to October 1, 1998.

S. 512 (Dorgan) and **H.R. 1410** (Istook) – would extend the Internet Freedom Act moratorium on multiple and discriminatory taxes for 4 years (through December 31, 2005) and provide that states that sufficiently simplify their sales/use tax systems may be allowed to collect sales/use tax from remote vendors. S. 512 provides criteria for a simplified sales tax system. The bill also calls upon the States to take the lead in developing and implementing a simplified, non-discriminatory sales tax system. In addition, S. 512 calls for a "joint, comprehensive study ... by State and local governments and the business community to determine the cost to all sellers of collecting and remitting State and local sales and use taxes on sales made by sellers under the law as in effect on the date of enactment of [S. 512] and under the [streamlined sales and use tax system called for in S. 512] to assist in determining what constitutes reasonable compensation." Finally, S. 512 calls for a single uniform statewide use tax rate on all remote sales. See Appendix B for further information.

S. 288 (Wyden) – would extend the Internet Freedom Act moratorium on multiple and discriminatory taxes for 5 years (through December 31, 2006) and provide a permanent ban on taxes on Internet access.[21] S. 288 also includes a Sense-of-the-Senate resolution providing criteria for simplifying the sales and use tax, which if followed by states could enable them to collect use taxes from remote sellers. See Appendix B for further information.

S. 245 (Smith) - "To make permanent the moratorium on the Federal imposition of taxes on the Internet."

S. 246 (Smith) - "To extend the moratorium on the [Federal] imposition of taxes on the Internet for an additional 5 years."

CALIFORNIA LEGISLATURE IN 2001

AB 81 (Migden, Aroner) is a reintroduction of AB 2412 vetoed by Governor Davis in 2000 (see earlier discussion). In March 2001, Arkansas enacted legislation that is very similar to AB 81. This legislation though is not a "prospective clarification" but is instead effective on and after January 1, 2002.[22] It is likely that due to the issues noted above, that this new law will be challenged in Arkansas.

[21] The Internet Tax Freedom Act (Public Law 105-277) passed on October 21, 1998, included a grandfather provision to allow state and local jurisdictions that were imposing and actually enforcing taxes on Internet access prior to October 1, 1998 to continue to do so. The following states fall under this exception: Connecticut (although the tax has been repealed effective 7/1/01), Hawaii (general excise tax), Montana, New Hampshire, New Mexico,, North Dakota, Ohio, South Dakota, Texas (first $25 of monthly access charges are exempt), Tennessee, Washington, and Wisconsin.

[22] Act 922 (HB 1440), see http://www.arkleg.state.ar.us/ftproot/bills/2001/htm/hb1440.pdf. Note that while AB 81 uses the term "prospectively clarify" it also states that it is not the intent of the Legislature to affect any tax agency action initiated prior to January 1, 2001. Thus, AB 81 would allow for new enforcement of the "clarified" law between January 1, 2001 and date of enactment.

INTERNATIONAL ACTIVITIES

Discussions of sales and use tax reform in the U.S. should not ignore similar discussions regarding value added taxes (VAT) outside of the U.S. International scalability should be considered in reform of the state and local consumption tax (sales and use taxes) since international transactions – both B2B and B2C will increase with the increased use of e-commerce. The U.S. is the only industrialized nation that uses a subnational level sales tax rather than a VAT. Activities at the international level in 2000 relevant to consumption taxes are summarized below.

A. OECD TAGs—Following an October 1998 OECD (Organization for Economic Cooperation and Development) conference in Ottawa, five *Technical Advisory Groups (TAGs)* were formed in the following areas: 1) technology, 2) professional data access, 3) consumption taxes, 4) business profits, ad 5) income characterization. Each TAG will function for two years and individuals from OECD member countries, non-OECD countries and the private sector are included in the TAG. The TAGs are to analyze tax issues in their particular area and work towards solutions.[23]

B. European Union Proposal for VAT Collection on Electronically-Delivered Services— In June 2000, the EU issued a proposed amendment to its Sixth Directive on VAT.[24] The amendment provides a mechanism to reduce the discriminatory result that presently occurs when VAT is applied inconsistently by vendors of digital goods and services. The proposal has been viewed as controversial in the U.S. because it requires non-EU businesses with annual EU sales of at least 100,000 EURO to private consumers to register in at least one EU country and collect VAT from non-business customers who purchase digitized goods and services.

Under the present VAT rules, services delivered electronically and originating in the EU are always subject to VAT. Electronically delivered services originating from outside of the EU are not subject to VAT even if delivered within the EU.

The EU did not wait for action on this issue by the OECD because they believe they are following the principles set forth in the 1998 Ottawa conference. That is, the EU believes it has considered (1) consumption taxes should tax in the jurisdiction where the consumption takes place, and (2) sale of digitized products should not be treated as a supply of goods.

Key aspects of the proposal include:

- The proposal applies to the following services supplied electronically:
    - "cultural, artistic, sporting, scientific, educational, entertainment or similar activities, including the activities of the organizers of such activities, and where appropriate, the supply of ancillary services … this includes all forms of broadcasting as well as other sound and images released and delivered by electronic means;
    - software: this includes for example computer games;
    - data processing … and explicitly including computer services including web-hosting, web-design or similar services;
    - the supplying of information."
- Non-EU vendors with annual sales within the EU of 100,000 EURO or less will not need to register.
- Non-EU vendors may register in a single EU country in order to, in effect, put "EU and non-EU operators on an equal basis when supplying to EU consumers."
- Systems for registration and filing of returns electronically will be established.
- Vendors will have access to information to "easily" distinguish whether a customer is private or a business.
- It is assumed that compliance will occur in order to avoid tax debt, penalties and interest, and the desire for access to legal protections of the EU, such as for intellectual property.

[23] For more information and current status, see http://www.oecd.org//daf/fa/e_com/tag.htm.

[24] Text available at http://europa.eu.int/comm/taxation_customs/proposals/taxation/tax_prop.htm.

▪ Tax obligations and sourcing are as follows:

	EU Business Customer	**Non-EU Business Customer**	**EU Private Customer**	**Non-EU Private Customer**
EU Vendor	▪ Place of supply = place where customer is established	▪ Place of taxation = customer location; thus, *not* subject to EU VAT	▪ Place of supply = location of supplier.	▪ Place of taxation = customer location; thus, *not* subject to EU VAT
Non-EU Vendor	▪ Place of taxation = EU ▪ No need to collect; customer must self-assess (reverse charge mechanism)	N/A	▪ Place of taxation = EU ▪ Charge VAT at rate applicable in the EU Member State in which vendor registered (unless meet the 100,000 de minimis exemption)	N/A

Issues/Queries:

▪ Is the proposal enforceable with respect to non-EU companies?

▪ How is the 100,000 EURO de minimis rule measured – by just considering sales of digitized items to private consumers? Sales to all consumers? All sales?

▪ Since digitized products are involved, how will vendors know the location of the customer?

▪ Under the proposal, while almost all digitized items will be taxed (except for items supplied by exempt vendors), the tax rate applied to purchases by private consumers will vary depending on where the non-EU vendor registers. This can lead to continued distortion.

▪ Why aren't all of the transactions taxed at the place of consumption (unless exempt, such as because it is an export)? [Sales by EU vendors to private EU customers are sourced at the location of the supplier.]

▪ Why not wait for the OECD member countries to agree on an approach to collection of tax from foreign vendors?

▪ Should the U.S. implement a similar system to ensure collection of state sales and use tax, even if collected at the federal level and then distributed to the states? How would such a system operate? Is simplification and uniformity of state sales tax systems a necessary first requirement? (probably)

Comments on the EU Proposal from the U.S. Treasury Department: In a speech to the Coalition of Service Industries and Tax Council in Washington, DC on July 26, 2000, Treasury Deputy Secretary Stuart E. Eizenstat made the following observations about the EU VAT proposal.[25]

▪ The proposal is not neutral in that it may tax electronically delivered goods at a higher rate than their physically-delivered counterparts. Thus, the proposal is contrary to the OECD's neutrality principle.

▪ The proposal may have "unintended consequences," such as causing retailers to give consumer information to the governments – a privacy concern.

▪ There could be "harm to industry" particularly if other countries adopt similar proposals that then increases the tax compliance obligations of e-commerce vendors. Also, if enforcement is lax, companies that do register could suffer a loss in customers as customers seek out vendors who do not collect VAT.

▪ The proposals is lacking specifics on "administration and enforceability." For example, how is a vendor to know whether the customer is a business or private consumer?

▪ The EU should have waited for action by the OECD to solve these complicated multijurisdictional issues so as not to impede the growth of e-commerce.

Neither has the proposal been overwhelmingly received in the EU. The European Information and Communication Technology Industry Association has proposed establishing a VAT rte of zero for digitized items

[25] Available at http://www.ustreas.gov/press/releases/ps808.htm.

for a two year period. In the meantime, the Association suggests that the EU could work with the EU and other regions to develop a model for taxing e-commerce.[26]

C. OECD Wants U.S. to Impose State Sales Tax on E-Commerce—The OECD's Economic Survey for the U.S. released in May 2000[27] suggests that for fiscal growth, e-commerce and mail-order business should be brought into the "sales tax net, especially as emerging technology is making the attribution of such taxes that much easier."

DEFINING NEXUS – A COMPARISON OF APPROACHES

[S664, ACEC, 86-272, AB 81, Michigan law, CA law]

COMMENTS ON APPROACHES TO STATE & LOCAL UNIFORMITY AND SIMPLIFICATION

How should uniformity and simplification be achieved? There are various possible approaches. A few of these are outlined below.

Congressional Mandate: For example, in 1959, Congress created uniform nexus rules for the states imposing income taxes on sales of tangible personal property by enacting P.L. 86-272. This law prohibits a state from taxing a foreign corporation's net income derived from activities within the state if those activities consist merely of solicitation of orders for the sale of tangible personal property that are approved, filled, and shipped from outside the state.

Multistate Tax Compact and UDITPA: The Multistate Tax Compact was written in 1966 and became effective in 1967 when seven States had adopted it. A significant stimulus for creating the Compact was the Supreme Court's decision in *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959) and congressional activity following the opinion. In *Northwestern States*, the Court held: "Net income from the exclusively interstate operations of a foreign corporation may be subjected to state taxation, provided the levy is not discriminatory and is properly apportioned to local activities within the taxing State forming sufficient nexus to support the same." Subsequent to the opinion, Congress enacted P.L. 86-272 (see above). This law also called for a study to consider uniform standards for the States in taxing income of interstate businesses.[28] In its consideration of P.L. 86-272 in 1959, the Senate noted that companies engaged in interstate commerce "are in doubt as to the amount of local activities within a State that will be regarded as forming a sufficient 'nexus,' that is, connection, with the State to support the imposition of a tax on net income from interstate operations and 'property apportioned' to the State." The Senate also noted that smaller companies were "fearful" of the costs of compliance primarily due to lack of uniformity in measuring taxable income to be apportioned among the states.[29] Such concerns led to some uniform laws – both through congressional action (P.L. 86-272) and state action (the Compact and UDITPA).

The purposes of the Multistate Tax Compact are to:

"1. Facilitate proper determination of State and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes.

2. Promote uniformity or compatibility in significant components of tax systems.

3. Facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration.

4. Avoid duplicative taxation."[30]

California is a member of the Compact.

The constitutionality of the Compact was upheld by the U.S. Supreme Court in *U.S. Steel Corp. v. Multistate Tax Comm'n.,* 434 U.S. 452 (1978). The Court found that the Compact did not violate the Compact Clause of Article I,

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26 Nigel Tutt, "EU Firms Favor Tax-Free Web," 2000 WTD 199-3.

27 Available at http://www.oecd.org/eco/surv/pdf/UnitedStates00.pdf.

28 The report was issued in June 1965 and is referred to as the "Willis Commission Report," because the Commission was chaired by Congressman Willis of Louisiana; House Rpt. No. 565, 89th Congress, 1st Session.

29 Senate Rpt. No. 658, Aug. 11, 1959, 1959 USCCAN 2548 (1959).

30 Article I of the Multistate Tax Compact; available at http://www.mtc.gov/ABOUTMTC/COMPACT.HTM.

10, clause 3 of the U.S. Constitution ("No State shall, without the Consent of Congress, … enter into any Agreement or Compact with another State …"). Based on precedent, the Court ruled that because the Compact did not increase political power within the States that would encroach upon or interfere with the supremacy of the U.S., it did not violate the Compact Clause. Neither did the Court find that the Compact violated the Commerce Clause or the 14th Amendment. The Court found that the Compact did not enable the States to exercise any powers they could not exercise absent the Compact, and that a State could withdraw from the Compact at any time.

The Compact addresses both income and sales and use tax rules. It includes procedures for interstate audits and creates the Multistate Tax Commission (MTC). Article IV of the Compact contains the Uniform Division of Income for Tax Purposes Act (discussed later).

The powers of the MTC include:

"(a) Study State and local tax systems and particular types of State and local taxes.

(b) Develop and recommend proposals for an increase in uniformity or compatibility of State and local tax laws with a view toward encouraging the simplification and improvement of State and local tax law and administration.

(c) Compile and publish such information as would, in its judgment, assist the party States in implementation of the compact and taxpayers in complying with State and local tax laws.

(d) Do all things necessary and incidental to the administration of its functions pursuant to this compact."

The MTC currently consists of 45 States; 21 are Compact Members (this includes California), 3 are Sovereignty Members, 18 are Associate Members, and 3 are Project Members.[31] New York is not a member of the MTC.

The Uniform Division of Income for Tax Purposes Act (UDITPA) provides uniform rules for apportioning income for state income tax purposes. "The UDITPA is a tax allocation system approved in 1957 by the National Conference of Commissioners on Uniform State Laws and by the American Bar Association. See 7A U. L. A. 91 (1978)."[32] California adopted UDITPA; the rules can be found at R&T §§ 25120 through 25139.

Other Efforts: Various simplification efforts have been pursued by professional and governmental organizations, such as the American Institute of Certified Public Accountants (AICPA), Committee on State Taxation (COST), Federation of Tax Administrators (FTA), National Governors Association (NGA), and the MTC. For example, the MTC has a list of sales tax simplification ideas.[33] These ideas include uniform registration procedures, uniform sourcing rules for determining where a sale should be taxed, common audit techniques, and limit the frequency of tax law changes. However, because not all states participate in the MTC, such simplification is difficult to achieve.

ADDITIONAL POINTS TO PONDER

- The sales and use tax system has been flawed for decades. It doesn't work well with numerous jurisdictions and interstate sales. Also, it taxes business purchases, which should instead be exempt to avoid pyramiding of the tax. Also, it only applies to tangible personal property, rather than to other types of consumption, such as intangibles and services. Note the date on the following quote:

> Significant problems have been encountered in the application of the [sales and use] tax to interstate transactions. Viewed broadly, these problems appear to stem from a tax system which tends to divide a national market into insulated blocks of consumers, with each sales tax State erecting its own scheme for taxing consumption within its borders. ... [A] firm selling in a number of States is required to meet the peculiarities of the law in each State. If the seller is beyond the jurisdiction of the State or otherwise does not collect the tax, the sale is likely to end up tax free. For local businessmen, this raises the specter of competitive disadvantage; for the States it means a loss of revenue. All things considered, the situation appears one in which it would appear entirely possible to fashion practical solutions to practical problems.
>
> *State Taxation of Interstate Commerce ("Willis" Report) June 1965*

- California has fiscal issues dating back at least to Proposition 13. Cities have become increasingly dependent on the sales tax and are incentivized to place retail and other sales offices in their jurisdictions, rather than housing

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31 See http://www.mtc.gov/ABOUTMTC/Aboutmtc.htm.

32 *Asarco Inc. v. Idaho State Tax Comm'n.,* 458 U.S. 307 (1982), fn. 3.

33 See http://www.mtc.gov/STSpage.htm.

or manufacturing or R&D operations. Also, various laws, such as from Proposition 13 and Proposition 218, limit the ability of local jurisdictions to raise taxes or impose new taxes.

- The key sales and use tax problem for state and local government is the inability to effectively collect the use tax on remote sales. While a solution will likely take many years, in the mean time, nothing is being done in most states, including California, to educate consumers about the use tax. A few states have a line on the state individual income tax form for the use tax (such as Michigan, North Carolina, Maine, Kentucky).
- The biggest problem for vendors is the complexity of the system caused by over 7,000 taxing jurisdictions and multiple sets of rules. Simplicity would require some level of uniformity, which is very difficult to achieve due to state sovereignty. The states do not have a strong history of adopting uniform rules on their own.
- Uniformity of rules among taxing jurisdictions is difficult to attain and to sustain. Local jurisdictions will prefer to have some control over their tax rate and base as opposed to having it set/fixed by a group of states or the federal government.
- Reaching uniform definitions is difficult. For example, the SSTP proposes that one fact that distinguishes candy from food is that candy doesn't contain flour. Thus, it would be necessary to read the ingredients listed on a package to determine if it is "candy" (which some states tax) or food (which some states may treat as exempt from tax). Since the uniform definitions are needed only to allow a state to be able to treat something as exempt from tax, perhaps it is the use of exemptions that is the complexity cause, not the definitions. If all tangible personal property were subject to sales tax, there would be no need for definitions of food, clothing and other items. To provide relief to low-income individuals for payment of sales tax on food, another type of relief could be provided, such as through the income tax. Of course, defining "tangible personal property" can also raise problems, but not as many. And, that problem could be avoided by subjecting all consumption (tangible and intangible personal property and services) to sales/use tax and lowering the tax rate.
- The sales/use tax is just one form of consumption tax. Perhaps other approaches should be examined, such as a valued added tax. Or, consumers could compute sales/use tax based on the formula: Income – savings = consumption. Of course, this system would not be simple due to the need for detailed recordkeeping to track changes in annual savings.
- Sales tax is just one issue: While the bulk of discussions on application of tax to e-commerce transactions today have pertained to sales tax and international taxes, there are issues in all types of taxes, including federal and state income taxes, telecommunication taxes, and perhaps even property taxes. As surviving dot-coms begin to generate income,[34] some of the state income tax issues will become more pressing. Effective reform of tax systems, should really consider all types of revenue that each jurisdiction imposes.

[34] A March 2001 study by ActivMedia Research has reported that 50% of online B2C vendors are generating a profit. See Clare Saliba, "Study: Half of E-tailers Are Turning a Profit," *E-Commerce Times*, March 13, 2001; http://www.ecommercetimes.com/perl/printer/8142/.

Appendix A—Traits of the E-Commerce Business Model and the Tax and Fiscal Issues They Raise

The chart below summarizes some of the tax issues facing businesses, as well as tax and fiscal issues for state and local governments posed by the e-commerce business model.

E-Commerce Traits	Tax & Fiscal Considerations for Businesses	Tax & Fiscal Considerations for Government	Examples
Location: ▪ Ability to interact with customers is not dependent on location. ▪ Can reach customers in many different states and countries without the need for many physical locations. ▪ Some physical assets needed to conduct business (such as servers) are not necessarily tied to a single physical location, but can easily be relocated without any interruption to business. ▪ Mobile equipment (servers through which web pages are accessed and orders processed) can easily be moved to a more favorable tax location. ▪ More custom inventories so less storage needs. ▪ Less vertical integration, more outsourcing.	▪ Reduced operating costs. ▪ Fewer physical facilities needed, so companies have a physical presence in very few states and countries in which they have customers. ▪ Sales tax issue of distinguishing between taxable goods and non-taxable services. ▪ Improved tax-planning opportunities due to lower costs of moving servers rather than physical structures.	▪ Land-use decisions. ▪ Increased competition among local jurisdictions as they work to encourage e-commerce companies to locate their physical facility in their jurisdiction. ▪ Onerous tax systems can more easily be avoided by businesses because is easy to relocate. Competition among taxing jurisdictions may increase. ▪ Greater likelihood that residents purchase from foreign (out-of-state) vendors—use tax collection issue; dealing with a global economy. ▪ May need to reconsider tax rules that base jurisdiction to tax on location. A server is not like a vending machine because the server's location is not tied to the ability to serve particular customers. Also, servers can be moved.	▪ Amazon.com (8 physical locations in U.S. and at least 3 in Europe, but customers in over 150 countries) ▪ Egghead.com (sells software only via the Internet) ▪ Purchase of cars via the Internet ▪ Musicmaker.com (custom CDs)
Transaction details: ▪ Possibility of anonymous transactions where products are delivered electronically and payment is made with electronic money.	▪ Streamlined operations that in many cases can be completed by a computer that can be located anywhere in the world.	▪ Difficulty of verifying that a transaction occurred and where it occurred; loss of an audit trail.	▪ Sale of software and other information electronically.

E-Commerce Traits	Tax & Fiscal Considerations for Businesses	Tax & Fiscal Considerations for Government	Examples
Nature of products: ▪ Digitized products, rather than physical products.	▪ Reduced costs of storage and delivery. ▪ Is the digitized product subject to sales and use tax? Laws vary from state to state. ▪ Shift from selling tangible products to digitized ones may cause shifts in state income tax liability and increased filing obligations because of different sourcing rules for tangible versus intangible sales and the fact that P.L. 86-272 does not apply to sale of intangible items. ▪ In many states, digitized products, as well as services, are not subject to sales and use tax. Thus, the tax base is shrinking. To maintain a more neutral tax system, consideration should be given to broadening the tax base and lowering the tax rate.	▪ Less tangible personal property - thus, smaller sales tax base. ▪ Fewer physical business locations are needed, so businesses are more likely to have customers in the state, but no physical presence (nexus). At the international level, countries will find that businesses have a permanent establishment (taxing presence for income taxes) in fewer countries. ▪ Should P.L. 86-272 be updated to also address nexus for state income tax purposes for sales of intangible items and services? ▪ Should souring of revenues be standardized among the states to avoid multiple taxation of income and to simplify multistate taxation rules? Today, for income tax purposes, most states source sales of tangible products to the destination state (in most states, if the seller is not subject to tax in that state, the sale is "thrown back" to the state of origin). Sales of intangibles are typically sourced to the state where the greatest income-producing activity occurs. However, a few states, such as Minnesota, source revenue from services and intangibles to the state where service is received or the intangible is used by the purchaser. ▪ Should sales and use taxes bases be broadened beyond tangible personal property?	▪ Music, books, videos, and software

E-Commerce Traits	Tax & Fiscal Considerations for Businesses	Tax & Fiscal Considerations for Government	Examples
Nature of transactions: ▪ Increased use of bartering (such as for advertising on web pages). ▪ Improved ability to reach a larger customer base by advertising on the Internet. ▪ Improved ability to match willing buyers and sellers. ▪ Improved use of technology to set prices.	▪ Valuation of the transaction for financial and tax reporting purposes. ▪ Ability to reach a broad market across many states and countries without the need for a physical presence, thus reducing multistate and international tax obligations. ▪ Reduced costs.	▪ Fewer intermediaries who may have previously served as a tax collection point. ▪ Valuation and reporting issues (bartering transactions are generally required to be reported to the government and the other party for tax purposes).	▪ http://www.bannerexchange.com ▪ E-Bay and other auction sites ▪ http://www.usbid.com/ ▪ http://www.tradeout.com ▪ http://bartertrust.com/ ▪ http://www.priceline.com/ ▪ Sept. 2000 report that Amazon.com was tracking data about customer buying habits and using variable pricing to retain customers. This is certainly easier to do on-line than in person at a store.[35]
Distribution methods: ▪ Reduced (or sometimes changed) need for intermediaries (disintermediation).	▪ Reduced costs to customers. ▪ Possible quicker service and closer tie to customers. ▪ New types of intermediaries created, such as ISPs, virtual malls, repair services and various portals. ▪ May change reduce number of places where vendor has nexus. For example, in some states, a vendor that has arrangements with a company to provide warranty services may be found to have nexus in the state where the repair company is located. An alternative today is to just sell (resell) customers a service contract between the customer and warranty repair company. For example, see WarrantyNow.com. ▪ May not be obvious whether intermediary needs to account for inventory under the tax rules.	▪ Fewer tax collection points. ▪ May need to attempt to collect tax (such as some excise taxes) from consumers or use new intermediaries.	▪ Sales of clothes from manufacturer to final consumer. ▪ Purchase of airline tickets directly form airline's web site. ▪ Consumer purchase of fishing equipment from outside of the U.S. where no excise tax is collected. ▪ Vendors arranging for sale of services directly between customer and third parties who will provide services (rather than the vendor being directly involved with the third party which may create nexus for the vendor).

[35] David Coursey, “Behind Amazon’s preferential pricing,” Yahoo! News, 9/11/00.

E-Commerce Traits	Tax & Fiscal Considerations for Businesses	Tax & Fiscal Considerations for Government	Examples
New Types of Assets: ▪ Domain names ▪ Web sites	▪ For federal and state income tax purposes, what is the nature of these assets? The answer is important to buyers so they can determine if the asset's basis can be amortized and to seller's to know the character of the gain or loss from disposition (capital or ordinary). ▪ Would the transfer be subject to sales/use tax?	▪ Do existing rules adequately address these types of new assets or is additional guidance needed?	▪ In 2000, the name "loans.com" sold at auction for a reported $3 million and in 1999, the name "business.com" sold for $7.5 million.[36]
Greater Outsourcing: ▪ Use of companies to create web sites and to store sites on servers ▪ Use of service companies to assist with technology deployment	▪ Does the relationship with the third party (outsourcing company) create nexus for the business in the locations where the third party is located?	▪ Existing rules on nexus may not be sufficient to address new transactions, such as web hosting.	Companies providing outsourcing services: ▪ Exodus Communications, Inc. ▪ Digital Island, Inc.
Global Marketplace: ▪ The Internet makes it easier and cheaper for even small businesses to sell goods and services in the global marketplace.	▪ Some small businesses may get involved in complex international and multistate tax issues.	▪ Tax agencies may find increased non-compliance due to lack of global tax expertise within small businesses.	▪ Various companies exist that provide assistance to small businesses engaging in e-commerce. For example: http://smallbusiness.yahoo.com/ http://Bigstep.com/
Workforce: ▪ Remote workforce that may be scattered throughout a state or country, rather than working in a single work location together.[37]	▪ Issues as to whether the presence of employees in the state creates tax obligations for sales, income and other tax purposes.	▪ Reduced infrastructure costs as more people work closer to their homes. ▪ Business license taxes applied to home workers.	▪ Customer support provided via the Internet with workers working out of their homes, rather than the company's physical location.

[36] The Associated Press, "Loans.com Domain Name Sells for $3 Million," *New York Times*, Technology Section, January 31, 2000.

[37] The GartnerGroup predicts that by 2003, one-third of the U.S. workforce will be working remotely at least one day per week. Jack Lessinger, author of *Penturbia*, predicts that more of the workforce will move from urban and suburban settings to telecommute from remote areas including resort areas and farms. "For Bettor or Worse, IT's Influence Over Our Daily Lives Will Only Grow," *Executive Edge*, June/July 1999, page 15.

E-Commerce Traits	Tax & Fiscal Considerations for Businesses	Tax & Fiscal Considerations for Government	Examples
Technology: ▪ Businesses using technology to track customer buying habits, adjust prices, track orders, etc.	▪ Improved customer service at lower costs.	▪ Can the software/data tracking be broadened to assist in tax determinations and collections?	▪ Amazon.com keeps track of all orders a customer has made (customer can access), makes book recommendation based on prior orders.
More Power to Customers: ▪ More information on products and prices is easily available to consumers from the Internet. ▪ It is easy to shop for the "best deal" without leaving your computer. ▪ Supplier exchanges can be formed to reduce inventory, improve availability of information and to speed up orders.	▪ Increased price competition and need to get information to consumers in a timely manner. ▪ Need to identify new ways to serve customers and suppliers.	▪ Increased competition may reduce number of companies and reduce profits. ▪ Opportunity to benefit from new ways of purchasing goods and services.	▪ Business-to-business supplier exchange formed in February 2000 by General Motors, Ford, and Daimler-Chrysler. ▪ Web sites that help consumers find the best deal on a particular product on the Internet.
Making Optimal Use of the Internet May Challenge Old Rules: ▪ New guidance may be needed for tax-exempt organizations using the Internet.	▪ Does a donor web link on a tax-exempt organization's web site considered an acknowledgement or advertising (which may create unrelated business taxable income (UBTI))? ▪ Does a donor receipt generated on the web satisfy the documentation requirement for deductibility of donations of $250 or more?[38]	▪ Do state tax rules need to be updated?	▪ http://www.cob.sjsu.edu/assoc/bap/sponsors.htm

[38] In October 2000, the Service issued Announcement 2000-84, 2000-42 I.R.B. 385, which lists various issues that tax-exempt organizations may face related to the Internet.

Appendix B—Simplification Perspective of SSTP versus Federal Proposals of the 107th Congress

As discussed earlier, both S. 288 and S. 512 of the 107th Congress include a list of factors deemed to be necessary elements of a state law providing for a simplified sales and use tax system for remote sales. These bills also state that adoption of such a simplified system would lead to a joint resolution allowing the state to collect sales and use tax on remote sales. The criteria laid out in S. 288 and S. 512 are not entirely the same and are not entirely the same as in the Streamlined Sales Tax Project. The following chart compares these proposals. The chart also notes where the National Conference of State Legislatures (NCSL) amended the SSTP.

Note: The following information is a summary, for specific details of the proposals, the full text of the SSTP Model Act and Agreement, as well as S. 288 and S. 512 should be reviewed.

Feature	SSTP	Federal Proposals: S. 288 and S. 512
Seller registration.	Requires an online sales and use tax registration system be used by the member states.	Requires a centralized, one-stop, multistate registration system.
Uniform definitions of goods and services.	Definitions provided for clothing, clothing accessories or equipment, sport or recreational equipment, protective equipment, food and food ingredients (which excludes alcoholic beverages and tobacco), candy, dietary supplements, soft drinks, food sold through vending machines, and prepared food. The importance of the definitions is in defining what is taxable or exempt under the system. For example, because "candy" is separately defined, it would be possible for a state to tax "candy" but to exempt "food." **NCSL:** Allows states to levy a lower rate on food, clothing, electricity, gas, and other specified items. Also, all uniform definitions were deleted and will undergo further review.	Requires uniform definitions for goods and services.
Other uniform definitions.	Definitions provided for delivery charges, purchase price, retail sale, sales price.	No specific requirements.
Level of administration.	State level administration must be provided for local sales and use taxes.	Same.
State and local tax base.	Through 12/31/05, all local jurisdictions in the state must have a common tax base. After that date, the local tax base must match that of the particular state.	No specific requirements.

Feature	SSTP	Federal Proposals: S. 288 and S. 512
Tax rates.	May not have multiple tax rates on items of personal property or services after 12/31/05. Local jurisdictions levying both a sales and use tax must use the same rate for each. Member states must "provide and maintain a database that assigns each five (5) digit and nine (9) digit zip code within the State to the proper tax rates and jurisdictions."	S. 288: Requires a single uniform statewide rate on all transactions – one-rate-per-state. S. 512: Requires a single, uniform Statewide use tax rate on all remote sales for sellers who adopt the "Compact." Allows for use of a weighted average tax rate. However, if a State "dramatically" simplifies its sales and use tax system "so that remote sellers can use information provided by the State to identify the single applicable rate for each sale, may require a remote seller to collect the actual applicable State and local sales or use tax due on each sale made in the State if the State provides such seller relief from liability to the State for relying on such information provided by the State."
Rate changes.	Member states must make a "reasonable effort" to give sellers as much advance notice as practicable regarding rate changes, limit the effective date to the first day of a quarter, notify sellers of legislative changes in the tax base.	No specific requirements.
Math.	Tax amount is carried to third decimal place. Round down if under ½ of one cent, otherwise round up. **NCSL:** Rounding provision deleted and to undergo further review.	No specific requirements.
Sales tax holidays.	The state may not apply an exemption after 12/31/03 unless the exempted item has been defined under the uniform definition provisions. **NCSL:** Provision deleted and to undergo further review.	No specific requirements.
Software certification.	CAS is certified.	Requires uniform procedures for certification of software relied upon by vendors to determine tax rates and taxability.
Sourcing rules.	Sourcing rules are the same for tangible goods, digitized items, and services (other than telecommunications). The rules: "a. When the product is received by the purchaser at a business location of the seller, the sale is sourced to that business location. b. When the product is not received by the purchaser at a business location of the seller, the sale is sourced to the location where receipt by the purchaser occurs, including the location indicated by instructions for delivery to the purchaser, known to the seller. c. When (a) and (b) do not apply, the sale is sourced to the location indicated by a address for the purchaser that is available from the business records of the seller that are maintained in the ordinary course of the seller's business when use of this address does not constitute bad faith.	Requires uniform rules for attributing transactions to particular taxing jurisdictions. S. 288 also provides that such rules be simple. S. 288: For goods or services delivered via the Internet, an "origin State default system" is required for transactions where the customer's location is not disclosed during the transaction. Under this rule, the seller would determine the sales or use tax using the law of the State where the seller is located. In addition, the seller would be permitted to rely upon information provided by the customer.

	d. When (a), (b), and (c) do not apply, the sale is sourced to the location indicated by an address for the purchaser obtained during the consummation of the sale, including the address of a purchaser's payment instrument, if no other address is available, when use of this address does not constitute bad faith. e. When none of the previous rules of (a), (b), (c), or (d) apply, including the circumstance where the seller is without sufficient information to apply the previous rules, then the location will be determined by the address from which tangible personal property was shipped, from which the digital good was first available for transmission by the seller, or from which the service was provided (disregarding for these purposes any location that merely provided the digital transfer of the product sold.)" A purchaser who plans to use the items at multiple locations must remit the required tax to the proper jurisdictions. *Query*: Are the sourcing rules intended to apply for all sales, or only for remote sales?	
Exempt purchasers and transactions.	General guidelines are provided for transactions where the purchaser is claiming a tax exemption. Sellers must maintain proper records of such transactions and provide them to a member state when requested. Member states must relive sellers from tax if they have followed the exemption procedures of the Agreement.	S. 288: Requires uniform rules that designate and identify purchasers and transactions that are exempt from sales and use tax, "including a database of all exempt entities and a rule ensuring that reliance on that database immunizes sellers from liability." S. 512: Requires uniform procedures for the treatment of exempt purchases and relief from liability for sellers relying on such procedures.
Exempt small sellers.	No rule.	Use tax collection exemption for remote vendors with gross annual sales less than a specified threshold of not less than $5 million.
Tax returns.	Requires only one return per taxing period per seller per state. Returns must be due no sooner than the 20th day of the month following the month in which the transaction occurred. All states to be capable of accepting electronically filed returns by 2003.	Requires uniform tax returns and remittance forms. S. 288: Requires a "single filing for all sales."
Remittances	Requires only one remittance per tax return unless seller collects over $30,000 in sales and use tax during the prior calendar year. Electronic remittances possible.	Requires uniform tax returns and remittance forms.
Electronic filing.	"Require, at each member state's discretion, All Model 1, 2, and 3 sellers to file returns electronically. It is the intent of the member states that all member states have the capability of receiving electronically filed returns by January 1, 2003.	S. 288: Requires uniform electronic filing and remittance methods. S. 512: Requires consistent electronic filing and remittance methods.

Feature	SSTP	Federal Proposals: S. 288 and S. 512
Audit procedures.	"Member states must conduct, or authorize others to conduct on their behalf, all audits of the sellers registered under this Agreement, and local jurisdictions shall not conduct independent sales or use tax audits of sellers registered under this Agreement."	Requires uniform audit procedures and an option that a seller agreeing to be subject to audit by any State won't be subject to more than one audit.
Bad debts.	Sellers must be allowed a deduction for bad debts. **NCSL:** Provision deleted and to undergo further review.	S. 288: Requires uniform bad debt rules. S. 512: No provision.
Privacy.	A Model 1 CSP must perform without retaining the personally identifiable information of customers; testing is required to verify.	Must provide protection for consumer privacy.
Vendor compensation.	Model 1 CSPs to be compensated by the states. Model 2 and 3 sellers will obtain compensation for 24 months and other compensation allowed by state law. **NCSL:** Above provision to remain pending completion of a joint public/private study of compliance costs.	Reasonable compensation for tax collection by vendors must be provided.
Amnesty	States participating in the SSTP are to give amnesty for uncollected or unpaid sales and/or use tax to vendors who register. Exceptions to amnesty exist if the vendor was registered with the state within the 12-month period preceding the State's participation in the SSTP Agreement, the vendor received notice of an audit which is not yet resolved, or there is fraud or intentional misrepresentation.	No provision.
Continued role of SSTP and State Advisory Committee.	Agreement can be amended by the SSTP prior to becoming effective (when at least 5 states have signed on). After that point, the Committee will be formed to continue the work of the SSTP. **NCSL:** States passing the Model Act may send up to four representatives to participate in multistate discussions to finalize the terms of the agreement. After 7/1/03, only states passing the Model Act and Agreement have voting authority. The SSTP becomes an advisory group to the governing states and not changes adopted by the SSTP as of 1/27/01 are binding on the governing states or the agreement.	N/A

Feature	SSTP	Federal Proposals: S. 288 and S. 512
Role of Congress	None specified. “This Agreement is among individual cooperating sovereigns in furtherance of their governmental functions. The Agreement provides a mechanism among the member states to establish and maintain a cooperative, simplified system for the application and administration of sales and use taxes under the duly adopted law of each member state.”	S. 288: No state may require a remote seller to collect or remit sales or use tax until Congress provides such authority to the State. Such authority would be derived from adoption of a joint resolution of Congress. Such authority will not be available if the State’s law imposes multiple or discriminatory taxation. S. 512: Authorizes the states to enter into an Interstate Sales and Use Tax Compact that describes a simplified system (as noted in S. 512). This authorization expires if the Compact has not been formed before January 1, 2006. To be formed, the Compact must have 20 States join. The Compact allows states to collect use tax from all sellers not qualifying for the de minimis exception.
Nexus for other purposes.	Section 6.e. of the Model Act provides: “No Nexus Attribution: The Agreement must provide that registration with the central registration system and the collection of sales and use taxes in the signatory states will not be used as a factor in determining whether the seller has nexus with a state for any tax.”	S. 288: Must provide “clear standards for determining the nexus of business activity, for tax purposes, that limit business activity tax nexus to sellers that have continuous and systematic contacts with the State.” S. 512: “In general, nothing in this Act shall be construed as subjecting sellers to franchise taxes, income taxes, or licensing requirements of a State or political subdivision thereof, nor shall anything in this Act be construed as affecting the application of such taxes or requirements or enlarging or reducing the authority of any State or political subdivision to impose such taxes or requirements.” Both S. 288 and S. 512 provide that a State’s authority to collect use tax from a seller has no effect on nexus determinations for other tax purposes.

For a list of states that have introduced legislation to consider or adopt the SSTP Model Act and Agreement, see information on the Streamlined Sales Tax Project at:

http://www.cob.sjsu.edu/facstaff/nellen_a/e-links.html.