

Perspective

Streamlined Sales Taxes

A one-year amnesty extended to retailers who register to participate in a streamlined state sales and use tax collection system is intended to serve as an attractive inducement. But some retailers are fearful that states could view data collected under the system as an “audit lead” for other taxes not covered by the amnesty. In this article, the authors urge states to modify the Streamlined Sales and Use Tax Agreement to expressly forbid such use of registration information.

Streamlined Sales Tax Amnesty Might Not Be Enough To Attract ‘Gray-Nexus’ Sellers to Register Under SSUTA

BY CHAROLETTE NOEL AND LIMING YUAN

On Oct. 1, 2005, the Streamlined Sales and Use Tax Agreement (SSUTA) formed from the Streamlined Sales Tax Project (SSTP) came into effect in 13 full-member states and five associate-member states. A key element of the SSUTA is a no-look-back sales tax amnesty offered by member states in exchange for the taxpayer’s agreement to collect sales tax in all current and future full-member states for at least 36 months, regardless of the taxpayer’s nexus with the respective member states.

While states view the amnesty as a strong inducement for retailers to register, there are unanswered questions about exactly how the program will work, particularly for those taxpayers whose nexus status is not completely clear. In this article, the authors argue that the SSUTA should be amended to prevent states from using information collected under the sales tax amnesty as audit leads for other kinds of taxes.

Appeal of SSUTA Amnesty

In the first two months after the SSUTA took effect, more than 200 businesses registered to participate in

the streamlined system, despite the lack of clear rules and guidelines for implementing the SSUTA amnesty. Many more taxpayers are currently evaluating the pros and cons of the SSUTA amnesty. The SSUTA amnesty is often appealing to taxpayers who sell goods solely through solicitations protected by Public Law No. 86-272,¹ since such taxpayers have no historic or future income tax exposure from the registration process.

Taxpayers with limited out-of-state contacts² who provide services or otherwise do not qualify for protection under Pub. L. No. 86-272 may seek assurance that SSUTA members states will not assert income, franchise, use or other non-sales tax nexus based on the SSUTA registration before agreeing to multistate tax collection responsibility and compliance costs. The federal limitations on taxation under Pub. L. No. 86-272 and the Commerce Clause in some ways have become less clear as the lines between goods and services blur and electronic transactions are more sophisticated and more prevalent.

Under the Commerce Clause, the federal constitutional limitation for taxation requires “substantial nexus” (among other factors established in *Complete Auto*³). But the standard of substantial nexus is far from a bright-line test, leaving many taxpayers in the zone of “gray-nexus.” Reasonable minds, and several state courts, differ as to whether particular facts reflect substantial nexus. Temporary and indirect contacts are frequent subjects of the gray-nexus debate.

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¹ 15 U.S.C. §381.

² Such taxpayers are referred to as gray-nexus taxpayers or gray-nexus sellers in this article.

³ *Complete Auto Transit Inc. v. Brady*, 430 U.S. 274 (1977).

Limited Participation Without More Radical Amnesty

Competing duties and economic interests fuel the gray-nexus debate. Businesses generally seek to return the highest value to shareholders or owners. State taxing authorities seek to support and protect the fisc. These competing economic interests, when combined with reasonable differences of opinion and unclear legal standards, seem sure to result in continued nexus litigation (or at least opposing reporting positions) until the economic interests are aligned or the legal standard is clarified.

To date, Congress has been content to leave constitutional and Pub. L. No. 86-272 disputes to the facts-and-circumstances determinations of the courts. Without substantial simplification of sales tax collection rules, it seems unreasonable for Congress to require every Internet or mail-order seller to comply with more than 1,000 different taxing schemes, many of which can be amended on any day that a city council or county/parish board meets.

Simplicity and conformity may help align the competing interests of business and taxing authorities, making it easier and less expensive to comply with and administer sales tax collection rules. But the risk of income, franchise, use or other non-sales tax exposure and the compliance costs for potentially unnecessary tax expenditures make it difficult to economically justify

voluntary sales tax collection for gray-nexus taxpayers.

From SSTP to SSUTA: Can BAC Pull Up SLAC?

In March 2000, the Streamlined Sales Tax Project, was organized among state tax administrators to radically simplify sales and use taxes. The SSTP's efforts resulted in the SSUTA. Upon the implementation of the SSUTA in October and the establishment of its Governing Board, composed of representatives of the full and associate member states, the SSTP ceased to exist and its roles and responsibilities were taken on by the State and Local Advisory Council (SLAC), while the Business Advisory Council (BAC) organized from the private sector.⁴

Most of the largest states participating in the SLAC (including California, New York, Texas, Illinois, and Florida) are not represented on the Governing Board because they have not yet conformed their laws to the SSUTA. At this stage, those states are participating as advisory states represented on the SLAC. The following chart illustrates participation in the SLAC as of Jan. 1, 2006:

⁴ SSUTA §§810, 811.

Category (and number of states in that category)				States
States not imposing a statewide sales and use tax (5)				AK, DE, MT, NH, and OR.
States (including D.C.) imposing a statewide sales and use tax (46)	States participating in the SLAC (45)	Member states on the Governing Board (19)	Full members (13)	IN, IA, KS, KY, MI, MN, NE, NJ, NC, ND, OK, SD, and WV.
			Associate members scheduled for automatic full membership (3)	OH (1/1/08), TN (7/1/07), and UT (7/1/06).
			Associate members requiring further compliance (3)	AR, NV, ⁵ and WY.
	Advisory states (26)	Advisory states with Enabling Act ⁶ (23)	AL, AZ, CA, D.C., FL, GA, HI, IL, LA, ME, MD, MA, MS, MO, NM, NY, RI, SC, TX, VT, VA, WA, and WI.	
		Advisory states without Enabling Act (3)	CT, ID, and PA.	
	State not participating in the SLAC (1)			CO

⁵ Nevada became an associate member on Jan. 1, 2006.

⁶ The Enabling Act is a state legislation that allows the state to enter into an agreement with one or more states to simplify and modernize sales and use tax administration. The SSTP envisioned two components to the legislation necessary to accomplish the project's goals. First, states adopt an Enabling Act. Second, states amend or modify their respective sales and use tax laws to achieve the simplifications and uniformity required by the participating states working together.

SSUTA's Amnesty Hook

SSUTA member states are required to provide an amnesty to sellers who have registered with the state under the SSUTA. The amnesty must preclude assessment for uncollected or unpaid sales or use taxes together with penalty or interest for "sales made during the period the seller was not registered in the state, provided registration occurs within twelve months of the effective date of the state's participation in the SSUTA."⁷ Both full members and associate members are required to offer the SSUTA amnesty.

The key advantage of the SSUTA amnesty is that it does not have a look-back period. However, the SSUTA amnesty is limited to uncollected or unpaid sales and use taxes on sales made to purchasers in the member states, and does not apply to other taxes.

The Sinker: SSUTA Registration May Trigger Nexus Exposure

To enjoy the SSUTA amnesty, a seller must register through the Central Registration System⁸ and agree to collect sales taxes for all member states. Upon registration, a seller must identify whether it is "legally required to report tax" in each of the member states. This information presumably is to be used by the member states in determining what compensation, if any, a seller or the certified service provider is entitled to for collecting taxes.

While the SSUTA does not correlate voluntary registration with substantial nexus, it currently does not strictly prohibit its member states from using such registration information as "audit leads" in locating taxpayers that may have nexus for other taxes. Section 401(D) of the SSUTA simply states that "[a] member state or a state that has withdrawn or been expelled shall not use registration with the central registration system and the collection of sales and use taxes in the member states as a factor in determining whether the seller has nexus with that state for any tax at any time."⁹ No provision of the SSUTA prohibits using the registration information to assist the states in auditing registered sellers for other taxes.

While many member states have expressed an intention not to use registration information as audit leads for other taxes, risk still exists for gray-nexus taxpayers in the absence of an applicable provision of the SSUTA preventing such a wrongful use. Although no SSUTA-based audits or inquiries have been reported, the mere possibility of such a wrongful use may keep gray-nexus sellers away from registering under the SSUTA.

States Attempt Solution

To avoid the problem described above, gray-nexus sellers who have potential liability for other taxes currently have options to obtain compliance with the member states before registering under the SSUTA.

⁷ SSUTA §402(A).

⁸ The Central Registration System is available at <http://www.sstregister.org/sellers/Register.aspx>.

⁹ SSUTA §401.

A seller may directly contact states to pursue separate voluntary disclosure agreements (VDAs) to resolve potential liability for the non-sales taxes. Most member states of the SSUTA provide a voluntary disclosure program that is usually effective for most of the taxes imposed in that state. In exchange for bringing these unpaid taxes to a state's attention, a state usually waives penalties (and frequently interest) that would otherwise be imposed on the unpaid taxes, and limits the number of prior years for which taxes must be paid. The usual look-back period is three to four years.

For instance, Kansas (a full member of the SSUTA) recently announced that taxpayers having unreported tax liability for a tax other than the sales tax or who otherwise do not qualify for the SSUTA amnesty may be eligible for a VDA with the Kansas Department of Revenue. Kansas' VDA applies to any tax administered by the Department, including the Kansas corporate income tax, property tax, and sales tax. The look-back period is three years. No penalties are imposed for late filing and payment. Interest will be due at the statutory rate on all tax due.

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Alternatively, taxpayers with potential liabilities in multiple states may contact the Multistate Tax Commission (MTC) to use the MTC's expedited VDA program. This expedited VDA program was recently developed through coordination of the Council On State Taxation (COST), the MTC and member states of the SSUTA. Under this program, VDAs will be handled through the MTC's National Nexus Program, which allows taxpayers to resolve potential tax liabilities simultaneously with multiple states.

All of the member states of the National Nexus Program have agreed to process any proposed VDA for other taxes due in a SSUTA member state on an expedited basis. All of the 19 member states of the SSUTA are members of the National Nexus Program, except Indiana and Nevada. Indiana and Nevada have, however, agreed to participate in this program in connection with the SSUTA. Stephen Kranz, tax counsel of COST, has noted that one of the advantages of this program is that it provides a one-stop-shop for taxpayers involved in multistate commerce to seek for tax settlements with multiple states.

How Can Member States Reel In Gray-Nexus Taxpayers?

To attract the gray-nexus sellers to register with the SSUTA (which might provide the economic justification to attract the large states to join the SSUTA), member

states and the Governing Board should seriously consider modifying the SSUTA to expressly prevent registration information from being used as an audit lead for other taxes. More definite rules and procedures should confirm that registration information may be used for sales tax purposes only, and will not be shared with non-sales tax personnel.

More member states should offer prospective amnesties for income, franchise, use and other non-sales taxes, particularly for gray-nexus taxpayers who may lack the “substantial nexus” for those taxes. Gray-nexus taxpayers typically have valid, or at least reasonable, arguments against a finding of substantial nexus.

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Thus, the usual three-to-four-year look-back period offered by the conventional VDAs may be an unacceptable price to pay for voluntary collection of sales taxes. The new VDA program handled through the MTC's National Nexus Program simplifies and expedites the existing VDA application process, but still does not offer enough incentives for most gray-nexus taxpayers. Providing prospective income and franchise tax amnesties

could add many gray-nexus sellers to the tax rolls and reduce lost sales tax revenue from Internet and mail-order sales.

Member states should also consider adopting more definite nexus rules for income, franchise taxes and use and other non-sales taxes. One suggestion may be to limit taxing nexus to those taxpayers who own or lease non-transitory property located in the state or have non-transitory employees working in the state. Under more definitive rules of nexus, gray-nexus taxpayers who have neither permanent properties nor regular employees in a state would have no added exposure to other taxes by joining the SSUTA. Such rules may bring more tax revenue to the member states and provide a win-win situation for both the states and the taxpayers.

Conclusion

The SSUTA and its amnesty program is appealing for many businesses protected by Pub. L. 86-272. Further income, franchise and other non-sales tax amnesty is needed to encourage broad SSUTA participation of gray-nexus taxpayers. Broad SSUTA participation of the gray-nexus sellers would reduce the amount of uncollected sales tax revenue. Adding significantly more taxpayer participants to the SSUTA would provide more economic pressure for the larger states to join the SSUTA to reap the benefit of having these remote sellers collecting sales tax nationwide. Broader support of a simplified sales tax system is needed if the SSUTA is to succeed. Without a simplified system, Congress is not likely to burden all sellers with a federal requirement to collect sales taxes nationwide.