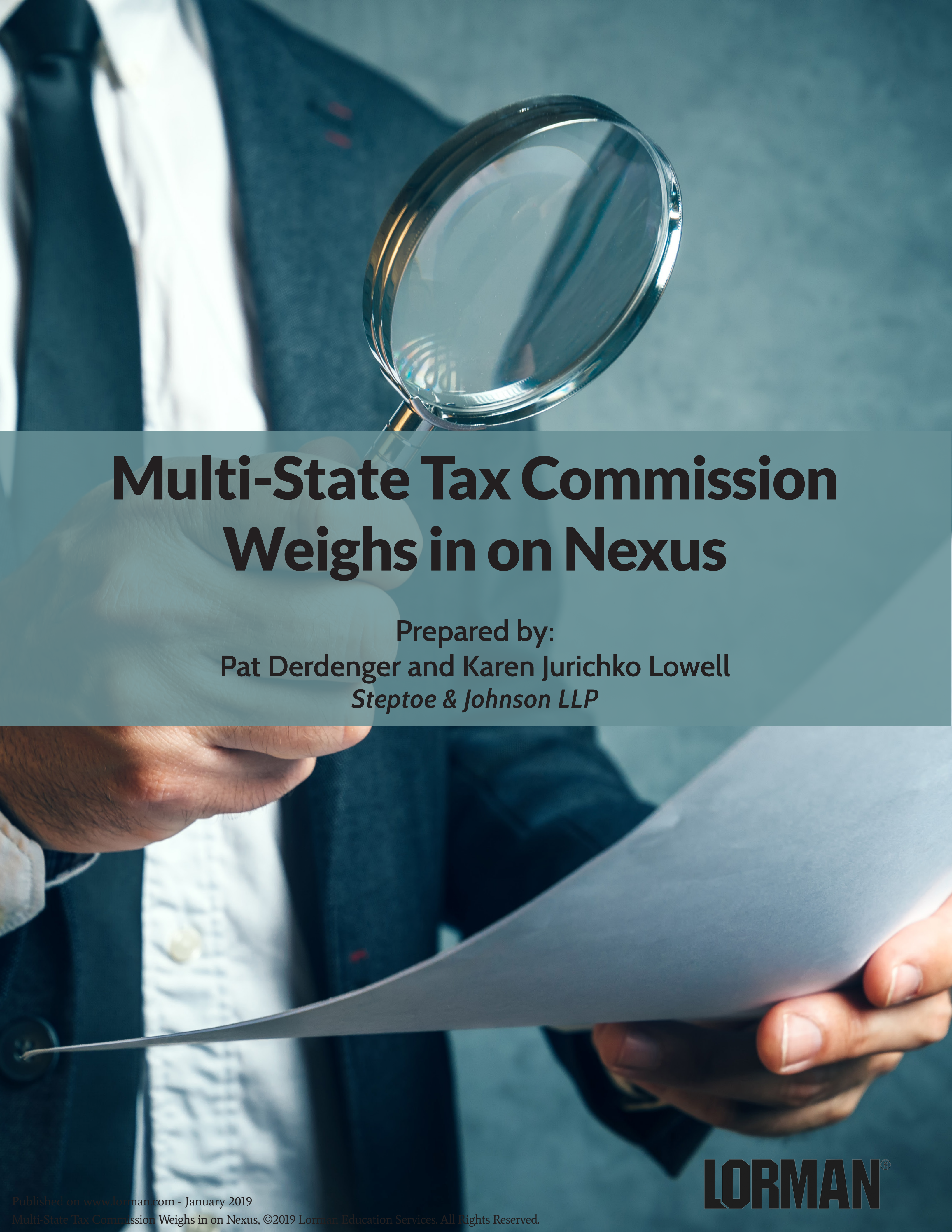

Multi-State Tax Commission Weighs in on Nexus

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MULTI-STATE TAX COMMISSION WEIGHS IN ON NEXUS

7.1 MTC Bulletin 95-1.

The Multi-State Tax Commission ("MTC") in 1995 issued a Nexus Bulletin, which has been approved by a number of states, taking the position that an out-of-state mail order computer vendor which contracts with a third party to provide in-state warranty repair services for its computers, creates sales and use tax and income tax nexus for the remote computer seller for both corporate income and sales or use tax purposes. MTC Bulletin 95-1 states that "the provision of in-state repair services provided by a direct marketing computer company as part of the company's standard warranty or as an option that can be separately purchased and as an advertised part of the company's sales, contributes to the company's ability to establish and maintain its market for computer hardware sales in the State." The MTC Bulletin did not address other services but its rationale could well apply to services other than repair.

Again, the MTC nexus guideline emphasizes the need to avoid any physical presence in the taxing state, including physical presence through independent contractors and agents acting on the out-of-state vendor's behalf, in order not to be saddled with the use tax collection obligation.

7.2 MTC Discussion Drafts.

The MTC has released a number of discussion drafts of possible nexus guidelines covering the sales and use tax collection obligation functions of out-of-state vendors. According to the MTC discussion drafts, the following activities may create nexus for remote internet or electronic commerce sellers:

- Ownership, lease, use, or maintenance of computer terminals available for access in the taxing jurisdiction;
- Licensing of proprietary software in the taxing jurisdiction that facilitates use of the on-line service;
- Utilization of a "cybermall" with a computer server in the taxing jurisdiction that performs various administrative and financial functions on behalf of the remote seller;

- Maintaining a telecommunication linkage by private contract in the taxing jurisdiction that permits the on-line service to establish and maintain a market in the taxing jurisdiction;
- Performing or rendering electronic services in the taxing jurisdiction, such as remote computer diagnostics and technical support.

Note: Because of industry opposition, the MTC never promulgated the drafts. However, the drafts alert taxpayers to the fairly aggressive nexus positions that states may take. *See* Pomp and Oldman, *State and Local Taxation*, 2d ed. – Volume 2, chapter 12, pages 1049-1050.

7.3 MTC Proposed Model Affiliate Sales Tax Nexus Provision.

An out-of-state vendor has substantial nexus with this State for the collection of use tax if both of the following apply:

- The out-of-state vendor and an in-state business maintaining one or more location within this State are related parties; and
- The out-of-state vendor and the in-state business use an identical or substantially similar name, trade name, trademark or goodwill to develop, promote, or maintain sales, or the in-state business provides services to, or that inure to the benefit of, the out-of-state business related to developing, promoting, or maintaining the in-state market.

Two entities are related parties under this section if they meet any one of the following tests:

- Both entities are component members of the same controlled group of corporations under § 1563 of the Internal Revenue Code;
- One entity is a related taxpayer to the other entity under the provisions of § 267 of the Internal Revenue Code;
- One entity is a corporation and the other entity and any party, for which § 318 of the Internal Revenue Code requires an attribution of ownership of stock from that party to the entity, owns directly,

indirectly, beneficially, or constructively at least 50% of the value of the outstanding stock of the corporation; or

- One or both entities is a limited liability company, partnership, estate, or trust, none of which is treated as a corporation for federal income tax purposes, and such limited liability company, partnership, estate, or trust and its members, partners, or beneficiaries own in the aggregate directly, indirectly, beneficially, or constructively at least 50% of the profits, capital, stock, or value of the other entity or both entities.

These provisions shall not apply to an out-of-state vendor that had sales in this State in the previous year in an amount of less than $100,000.

FEDERAL INTERNET TAX LEGISLATION.

8.1 Internet Tax Freedom Act.

The use tax collection cases, for the most part, deal with mail order vendors and not internet vendors. However, *Quill's* Commerce Clause nexus requirement of more than "slightest physical presence" applies equally to both types of sales. In other words, for a remote internet seller to be required to collect the use tax in the purchaser's state, that internet seller must have physical presence which is more than "slightest physical presence" in the taxing state. As a result, this author draws no distinction in this analysis between the company store's mail order sales and internet sales.

The Omnibus Appropriations Act of October 21, 1998 (P.L. 105-277) included the Internet Tax Freedom Act, which sets forth the federal policy against state and local government interference with and taxation of interstate commerce on the Internet. The Internet Tax Freedom Act, under Congress' jurisdiction over interstate commerce, establishes a moratorium on the imposition of taxes on the internet. Specifically, the moratorium provides that "no state or political subdivision thereof shall impose any of the following taxes during the period beginning on October 1, 1998, and ending three years after the date of the enactment of this Act:

1. Taxes on Internet access, unless such tax was generally imposed and actually enforced prior to October 1, 1998; and

2. Multiple or discriminatory taxes on electronic commerce."

The Internet Tax Freedom Act originally prohibited for three years any new taxes on internet access or multiple or discriminatory taxes on electronic commerce. The Internet Tax Freedom Act does not, however, impose a moratorium on a state's use tax collection obligation for sales made via the internet, as long as the Commerce Clause requirement of something more than "slightest physical presence" is met, and such an Internet use tax collection duty is not discriminatory. To be expected, the states will undoubtedly search for some type of physical presence by an internet seller in the taxing state, in order to impose the state's use tax collection obligation on that remote Internet seller.

A. Internet Tax Freedom Act Moratorium Extended to November 1, 2003.

On October 21, 2001, the federal Internet tax moratorium expired. On November 28, 2001, however, Congress extended the moratorium to November 1, 2003. The Internet Tax Nondiscrimination Act (Public Law No. 107-75) made no changes to the 1998 legislation that created the moratorium.

B. Moratorium on Internet Access Charges Extended to November 1, 2007.

Congress passed legislation in November 2004 that extended the moratorium on state and local Internet access taxes to November 1, 2007.

The previous moratorium, which was first enacted in October 1998 under the Internet Tax Freedom Act ("ITFA"), expired on November 1, 2003. The Senate originally approved legislation in April 2004 to expand the ITFA moratorium and reinstate it until 2007. However, the House refused to concur in this legislation because it was holding out for a permanent ban. On November 17, 2004, the Senate made two minor amendments to its previously passed legislation, which the House then accepted. Specifically, the legislation does the following:

- Prohibited, beginning November 1, 2003, and ending November 1, 2007, state and local taxes on Internet access, and multiple or discriminatory state and local taxes on electronic commerce (reinstating the ITFA moratorium originally enacted in 1998);

- Extended until November 1, 2007 the original ITFA grandfather clause that permitted Internet access taxes that were generally imposed and actually enforced prior to October 1, 1998[1];
- Expanded the definition of exempt internet access to include telecommunications services "to the extent such services are purchased, used, or sold by a provider of Internet access to provide Internet access," narrowing the moratorium exception for taxes on telecommunications services that had been used by some states to tax digital subscriber line ("DSL") service, and it presumably exempting telecommunications services used by internet service providers over the so-called internet backbone (i.e. the "middle mile" of access);
- Enacted a new grandfather clause to permit, until November 1, 2005, other internet access taxes that were generally imposed and actually enforced as of November 1, 2003 (this provision permits, for instance, states and localities that were taxing DSL service to continue to do so for another two years, despite the narrowed exception for taxes on telecommunications services);
- Provided that taxation of charges for voice or similar service using Voice Over Internet Protocol ("VOIP") are unaffected (this exception for taxation of VOIP services specifically does not apply to services incidental to internet access, such as voice-capable e-mail or instant messaging);
- Amended the ITFA definition of "tax on Internet access" to state specifically that it applies regardless of whether a tax is imposed on a provider of internet access or a buyer of internet access, and regardless of the terminology used (the definition, however, would specifically exclude taxes on, or measured by, net income, capital stock, net worth, or property value);

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[1] The grandfather clause for the Wisconsin telecommunications service tax was extended only until November 1, 2006.

- Allowed the taxation of otherwise exempt internet access service that is bundled with taxable services, unless the internet access provider can reasonably identify the charges for internet access from its books and records kept in the regular course of business;
- Specified that the Texas municipal access line fees are unaffected; and
- Directed the Government Accountability Office ("GAO") to study the impact of the moratorium on the revenues of state and local governments and assess whether ITFA has had an impact on the deployment or adoption of broadband Internet access services.

Source: CCH NEWS-STATE, 2005 TAXDAY, (Nov. 22, 2004), Item #S.2, All States–Multiple Taxes: Congress Approves Ban on Internet Access Taxes Through 2007.

C. Moratorium on Internet Access Charges Further Extended to November 1, 2014.

In October 2007, Congress enacted another extension to the ITFA. Public Law 110-108, among other things, extended ITFA's moratorium on the state and local taxation of internet access through November 1, 2014. Specifically, the legislation does the following:

- Prohibited, beginning November 1, 2003 and ending November 1, 2014, state and local taxes on internet access and multiple or discriminatory state and local taxes on electronic commerce;
- Redefined the term "internet access," effective in certain circumstances retroactively to November 1, 2003, to curb states from overreaching in claiming exemption from the moratorium. The bill, however, pushed back the effective date of the new definition until June 30, 2008 in the case of a tax imposed on internet access that is either: (1) generally and actually imposed on telecommunications services purchased, used or sold by a provider of internet access if the appropriate state or city agency issued a public ruling before July 1, 2007 that was inconsistent with the new definition; or (2) litigation seeking to enforce such a tax inconsistently with the new definition was instituted in a competent court before July 1, 2007;

- Expanded "internet access" to include internet-based communication services, such as e-mail and instant messaging. The bill also redefined "telecommunication services," which are exempt to the extent they are purchased, used or sold by a provider to provide internet access, as "telecommunications" and expanded the definition to include unregulated, non-utility services such as cable services;
- Created another exemption from the moratorium by adding a specific exception to the definition of "tax on internet access." Taxes that were enacted between June 20, 2005 (with the exception of certain business and occupation taxes enacted earlier) and November 1, 2007, that wholly or partially replaced value-added, net income, capital stock, or net worth taxes and that expressly levy tax on commercial activity, modified gross receipts, gross income, or taxable margin are exempt from the moratorium as long as the tax applies to a broad spectrum of businesses and does not discriminate against internet access, telecommunications or telecommunications service providers;
- Prohibited states from taxing under a grandfather provision if the state repealed or nullified its tax on internet access at some point before October 31, 2005.

D. Internet Tax Freedom Act Made Permanent.

After numerous extensions, the ban on taxes on internet access was made permanent on February 24, 2016, when President Obama signed H.R 644, a trade and customs bill.

Previously, Congress acted three times to extend the ITFA, which was set to expire on December 11, 2015. Public Law No: 113-235 (12/16/2014); Public Law No: 113-164 (9/19/2014); H.R. 719 (passed 9/30/2015).

Various earlier proposals to make the moratorium on taxes on internet access permanent all failed. On June 9, 2015, the House passed H.R. 235, the Permanent Internet Tax Freedom Act, which would have made the ban permanent but did not address states that are grandfathered in under current legislation. Additionally, in February 2015 the Internet Tax Freedom Forever Act

(S. 431) was introduced by Senators Ron Wyden (D-Ore.) and John Thune (R-S.D.). This bill would have permanently ban taxation of internet access and would have extended the ban to all states, including the seven grandfathered in under the original ITFA.

8. 2 Prevent All Cigarette Trafficking Act (the "PACT Act") – Pub. L. 111-154 (March 2010).

In 2010, Congress enacted the PACT Act with the goal of fighting crime and increasing government revenues through the collection of federal, state and local tobacco taxes on cigarettes and smokeless tobacco sold via the internet or other mail-order sales. Additionally, Congress felt that by reducing the availability of low-cost (and tax-evading) cigarettes over the Internet, the PACT Act would also prevent and reduce smoking and its many harms and costs, particularly to children. Other reasons cited by Congress for the bill included lost revenue, terrorist involvement in tobacco trafficking, insufficient check on sales to minors, unfair competition to retailers, and a significant increase in internet tobacco vendors.

The bill requires any cigarette or smokeless tobacco vendor making remote sales to collect and remit any state, local or tribal excise tax before making delivery. Congress considered the harms listed above "unique" to tobacco products. However, Section 8 of the act states that "[t]his act is in no way meant to create a precedent regarding the collection of State sales or use taxes by, or the validity of efforts to impose other types of taxes on, out-of-State entities that do not have a physical presence in the taxing State."

In short, Congress used its Commerce Clause power to require the payment of the destination state's tobacco tax even though the out-of-state vendor has no physical presence in the destination state.

Taxpayers have challenged the validity of the PACT Act on due process grounds. In *Red Earth LLC v. U.S.*, 657 F.3d 138 (2d Cir. 2011), a small Indian internet-based tobacco vendor challenged the act because it would require the vendor to collect and remit tax based on a single sale, when the taxpayer has no connection with the taxing state that would satisfy due process concerns. The U.S. District Court for the Western District of New York enjoined enforcement of the act and the Second Circuit Court of Appeals upheld the injunction.

8.3 Proposed Federal Legislation Impacting State Taxes.

A. 2011 Proposals

Main Street Fairness Act of 2011 (H.R. 2701, S. 1452).

This bill was introduced on July 1, 2010 and authorized each Streamlined Sales Tax Project ("SSTP") member state to require all remote sellers that do not qualify for the small seller exception to collect and remit sales and use tax.

2011 Supporting the Preservation of Internet Entrepreneurs and Small Businesses (H. Res. 95, S. Res. 309).

Introduced in the U.S. House of Representatives on February 16, 2011, this resolution proposed that Congress "should not enact any legislation that would grant State governments the authority to impose any new burdensome or unfair tax collecting requirements on small online businesses and entrepreneurs."

Marketplace Equity Act of 2011 (H.R. 3179).

Introduced on October 13, 2011, this act was based on a proposed bill drafted by the Retail Industry Leaders Association ("RILA"). Unlike the Main Street Fairness Act, this bill did not require states to be SSTP members to require remote vendors to collect and remit sales and use tax. Rather, the bill would have required remote vendors to collect sales tax as long as state law provided for certain simplifications and features, such as a small seller exception.

Under the Marketplace Equity Act, remote vendors would have to collect and remit sales or use tax, as long as state law provided:

- A single tax return and a single authority to which the return must be filed;
- An identical tax base and exemptions for remote sellers;
- A small seller exception for remote vendors with less than $1 million in annual sales nationally or less than $100,000 in the taxing state; and
- A rate structure prescribed by federal law.
- Additionally, there were three optional rates under the bill:

- A single state-wide blended rate, comprised of the state rate and the applicable local jurisdiction rate;
- A maximum state rate, which was the highest rate at which sellers were required by the state to collect tax, exclusive of the rate imposed by local jurisdictions; or
- The actual combined rate based on destination sourcing.

Marketplace Fairness Act of 2011 (S. 1832).

Introduced on November 9, 2011, this bill shared many features with the Marketplace Equity Act; it allowed all states, regardless of SSTP membership, to require remote vendors to collect and remit sales tax, as long as the state adopted certain minimum simplification measures. These simplification measures included:

- A single sales tax return to be used by all remote vendors, single state level sales tax administration, and a single audit for all state and local sales taxes;
- A uniform sales and use tax base between the state and local taxing jurisdictions;
- The use of a destination sales tax rate; and
- A small seller exception for remote vendors that make less than $500,000 annually in the U.S.

Digital Goods and Services Tax Fairness Act of 2011 (H.R. 1860, S. 971).

This bill was originally introduced in 2010 and was reintroduced in 2011. It prohibited a state or local taxing jurisdiction from imposing multiple or discriminatory taxes on the sale or use of electronically transferred, digital goods and services. It also allowed states to impose retail and sales and use taxes on the sale of digital goods and services only if the customer's tax address was within the state seeking to impose the tax.

The bill contained several definitions of "tax address" depending on whether the seller is a mobile telecommunications provider under 4 U.S.C. § 117 and whether the customer's address was known to the seller.

Finally, the bill also provided for the tax treatment of bundled transactions. A similar bill was introduced in July 2013 as the Digital Goods and Services Tax Fairness Act of 2013 (S. 1364).

B. 2013 Proposals

<u>Permanent Internet Tax Freedom Act of 2013 (H.R. 3086); Permanent Internet Tax Freedom Act of 2015 (H.R. 235).</u>

These bills would make the Internet Tax Freedom Act permanent. H.R. 3086 passed the House in July 2014, and has remained pending in the Senate since then. Similarly, H.R. 235 passed the House in June 2015, and is currently pending with the Senate.

<u>Marketplace Fairness Act of 2013 (2013: H.R. 684, S. 336, S. 743).</u>

This Act was introduced in both the Senate and the House on February 14, 2013, and was reintroduced again on March 10, 2015. The Act built on attempts to address issues and reconcile approaches taken in the several 2012 remote vendor nexus bills. The Act would authorize states to require remote vendors to collect and remit sales tax if: (1) the states are SSTP members; or (2) the states meet minimum simplification requirements.

SSTP Members: SSTP members would be authorized to require collection from remote vendors on sales that are sourced to those states under the Streamlined Sales Tax Agreement. SSTP member states could begin requiring collection 90 days after publishing a notice of intent to exercise such authority, but could not begin collecting tax from remote vendors until the first day of the calendar quarter that is at least 90 days after enactment of the Act. Additionally, the SST Agreement would have to include all of the minimum simplification requirements discussed below.

Non-SSTP Members: States that adopted minimum simplification requirements could also require remote vendors to collect sales tax on remote sales made into those states. Non-SSTP member states could begin requiring collection the first day of the calendar quarter that begins at least six months after the state enacts legislation to exercise the authority granted by the federal Act. Each state’s legislation must specify the tax or taxes to which the remote vendor collection and simplification requirements would and would not apply.

Minimum Simplification Requirements: In order to require collection from remote vendors, non-SSTP member states (and the SST Agreement for member states) would have to adopt the following eight simplification requirements:

- *Single-point administration* – a single entity would have to be responsible for sales and use tax administration, return processing, and audit functions with respect to all state and local sales and use taxes imposed by the state or its political subdivisions. Additionally, remote vendors would only have to file a single sales tax return with that entity and returns could not be required on a more frequent basis than returns are required from non-remote sellers.
- *Uniform state and local tax base* – there must be a uniform sales tax base among the state and local taxing jurisdictions.
- *Uniform sourcing* – each state must source sales in accordance with the provisions of the Act, which uses a waterfall approach. Sales are sourced to the delivery location provided by the purchaser to the seller. If no delivery location is provided, the sale is sourced to the purchaser's address (including a payment instruction address) as known by the seller or as obtained by the seller during consummation of the transaction. When no delivery location is available, sales are sourced to the address of the seller from which the remote sales was made.
- *Compliance software and information* – the Act requires states to provide information indicating the taxability and exemption of products and services and a rates and boundaries database. Additionally, states would have to provide software to remote vendors, free of charge, that automatically calculates sales and use taxes due on each transaction at the time the transaction is completed, that automates sales tax return filing, and that is kept up to date to reflect state and local rate changes. States would also have to provide certification procedures in order for entities to be approved as certified software providers ("CSP") for the purposes above.

- *No vendor liability for CSP errors* – states must relieve remote vendors of liability, including penalties and interest, if the liability results from an error or omission made by the CSP.
- *No CSP liability for vendor or state errors* – CSPs will not be held liable for errors and omissions if the CSP received inaccurate or misleading information from the remote vendor or inaccurate information or incorrect software from the state.
- *90-days' notice for tax base and rate changes* – each state would have to provide both remote vendors and CSPs 90-days' notice regarding changes to the tax base or rates. If the notice is not provided, the state must relieve the remote vendor and the CSP from tax, at the rate in effect preceding the change for 90 days before the change.

Small Seller Exception: Whether a SSTP member or not, no state would have authority to require collection by a remote vendor that meets the small seller exception. A remote vendor meets the small seller exception if its gross annual sales in the U.S. during the preceding calendar year were $1 million or less. For purposes of this threshold, sales between all related persons within the meaning of IRC §§ 267(b) and (c) or 707(b)(1) are automatically aggregated. Sales among entities with any related ownership may also be aggregated if the principle purpose of the entity structure is avoidance of the remote collection responsibility.

The Marketplace Fairness Act was referred to the House Judiciary Committee on June 14, 2013, where it continues to languish. Supporters of the Act acknowledged early on that the bill would face considerable opposition in the House, largely based on the small seller exception provisions. As the bill moved from the Senate to the House, the bill's supporters, including the nation's large retailers, were pitted against conservative think tanks, such as the Heritage Foundation, who viewed the bill as essentially another tax on the nation's consumers. However, small internet seller alliances have also begun to weigh in, focusing their criticism on the simplification measures and attacking some of the real and perceived premises surrounding small internet vendors and sales taxation. Specifically, the small vendors argue that simplification measures in the MFA do not go far enough, as they do not fully address uniformity among jurisdictions with respect to exemptions and would still require small internet vendors to ferret out tax rates in some 9,600 separate jurisdictions. They argue that compliance costs will soar due to increased audits and the diversion of resources to attend to those audits. Additionally, while compliance software is to be distributed for free under the Act, the small retailers note the first year costs alone associated with integrating the free software into their systems can range from $20,000 to $300,000 per business.

The Marketplace Fairness Act has seen substantial support from state governments, as some have passed resolutions urging Congress to pass the Act. Additionally, in November 2014 the National Governors' Association along with six other organizations representing the nation's state and local elected leaders sent Congress a letter in support of the Act.

C. 2015 Proposals

Marketplace Fairness Act of 2015 (2015: S. 698).

The Marketplace Fairness Act was reintroduced in 2015. Please see the discussion of the Marketplace Fairness Act of 2013, above, for a detailed description of this proposal.

Remote Transactions Parity Act (H.R. 2775)

The Remote Transactions Parity Act, introduced on June 15, 2015, would authorize both Streamlined Sales and Use Tax Agreement member and non-member states to require remote sellers to collect and remit sales and use taxes with respect to remote sales sourced to such states.

Non-member states must first demonstrate that they have adopted and implemented minimum simplification requirements for the administration of sales and use taxes before they can collect such taxes. Requirements include:

- The designation of a single state entity responsible for all state and local sales and tax administration, return processing, and audits of remote sales;
- A single audit of a remote seller for all taxing jurisdictions in the state;
- Direct contact with a certified software provider utilized by the remote seller in conducting an audit;

- A single sales and use tax return for use by remote sellers that is filed with a single entity responsible for tax administration;
- A uniform sales and use tax base; and
- Sourcing of all remote sales in compliance with criteria established by this Act.

The bill prohibits states from requiring remote seller to file sales and use tax returns more frequently than local sellers. Additionally, remote sellers whose gross annual receipts are less than $5 million would be exempt from audits unless there is a reasonable suspicion of intentional misrepresentation or fraud.

The bill features a phase-in period last the first three years after the effective date of the Act. During the phase-in period, only remote sellers whose gross annual receipts exceed a certain level ($10 million during year one, $5 million during year two, and $1 million during year three) and who utilize an electronic marketplace for making sales would be required to collect and remit sales and use taxes. After the three-year phase-in period, all remote sellers must collect and remit sales and use taxes. The bill also features a moratorium on the collection of state sales and use taxes by a state between October 1 and December 31 of the first year in which the Act takes effect.

Finally, the bill also would prohibit a state from collecting sales and use taxes from remote sellers unless the state: (1) provides certification procedures for persons to be approved as certified software providers; (2) refrains from denying or revoking certification to software providers without a reasonable basis; (3) has certified multiple national certified software providers; and (4) provides compensation for certified software providers.

The House Judiciary Committee referred the bill to its Subcommittee on Regulatory Reform, Commercial and Antitrust Law on July 1, 2015.

<u>Business Activity Tax Simplification Act (H.R. 2584)</u>

The Business Activity Tax Simplification Act, introduced in the House on June 1, 2015, would expand the federal prohibition against state taxation of interstate commerce to: (1) include taxation of out-of-state transactions involving all forms of property, including intangible personal property and services; and (2) prohibit state taxation of an out-of-state entity unless such entity has a physical presence in the taxing state. Currently, only sales of tangible personal property are protected.

The Act also sets forth criteria for determining that a person has a physical presence in a state, including: (1) being physically present in the state, or assigning one or more employees to be in the state; (2) using the services of an agent (excluding an employee) to establish or maintain the market in the state, if that agent does not perform business services in the state for any other person during such taxable year; or (3) the leasing or owning of tangible personal property or real property in the state. Under the Act, a person does not have physical presence in the state if he or she is present in the state for fewer than 15 days during the taxable year (or higher number if permitted under state law) or is only present in the state to conduct limited or transient business activity.

The Act also proposes criteria for the computation of the tax liability of affiliated businesses operating in a state. The bill is currently with the House Judiciary Committee.

<u>Digital Goods and Services Tax Fairness Act (H.R. 1643)</u>

This bill, introduced in the House on March 26, 2015, would prohibit a state or local jurisdiction from imposing multiple or discriminatory taxes on the sale or use of a digital good or service delivered or transferred electronically to a customer. "Digital services" would not include: (1) any service that is predominantly attributable to the direct, contemporaneous expenditure of live human effort, skill, or expertise; (2) a telecommunications service; (3) an ancillary service; (4) an internet access service; (5) an audio or video programming service; or (6) a hotel intermediary service.

The bill would also restrict taxation of a digital good or service to taxation by a state or local jurisdiction whose territorial limits encompass a customer tax address, as defined by the Act. The seller of digital goods or services would be responsible for obtaining and maintaining such address.

The bill is currently with the House Judiciary Committee.

D. 2016 Proposals

<u>Online Sales Simplification Act of 2016 (Draft, 8/25/2016)</u>

In January 2015, House Judiciary Committee Chairman Bob Goodlatte (R-Va.) circulated a draft bill called the Online Sales Simplification Act ("OSSA"). Rep. Goodlatte's draft measure adopts a hybrid version of so-called origin sourcing, which taxes items based on the seller's location and not where the customer lives. This proposal represents a sharp departure from the Marketplace Fairness Act. The draft proposal was widely panned by participants at a May 2015 Streamlined Sales Tax Governing Board meeting.

In August 2016, Rep. Goodlatte released a revised Discussion Draft that lays out a system in which remote sellers' collection and remittance of states' sales and use taxes would depend on whether a state is a member of the "clearinghouse," an entity which would collect and distribute the sales and use taxes according to the draft's rules. The draft defines "origin state" as the state where the remote seller has the most employees, and the destination state is based on the location of the buyer.

Under the proposed bill, states are only permitted to impose a sales, use, or similar tax if they meet three requirements:

- The state is the origin state of the remote seller (i.e., where the seller is located);
- The tax is applied using the same tax base as in-state, non-remote sales; and
- The state participates in the "clearinghouse" created by the law.

The proposal also creates uniform rules for the applicable tax rate and tax base for all remote sales. If the destination (buyer's) state is a clearinghouse participant, then the destination state's rate applies. If the destination state does not participate in the clearinghouse, then the rate of the origin (seller's) state applies. Additionally, states are required to create a single, statewide tax rate that applies to all remote sales. In all cases, taxability of the sale is determined using the laws of the seller's state, although the proposal allows for certain modifications if a state opts to create a "uniform compliant purchaser certificate."

Sales into Clearinghouse States that Impose a Sales Tax: Remote sellers that sell to buyers located in a clearinghouse state that imposes a tax are required to collect the tax from the buyer. The taxability of the sale is determined using the law of the seller's state, and the sale is taxed using the single, statewide rate for remote sellers of the buyer's state. The seller remits the tax to its home state, which in turn remits the tax to the clearinghouse. The clearinghouse then distributes the tax to the destination (buyer's) state.

Sales into Non-Clearinghouse States that Impose a Sales Tax: For these sales, the remote seller's location is used to determine both the tax rate and the base. The non-member destination state does not receive any of the tax from the clearinghouse; instead, all tax collected is retained by the seller's state.

Remote Sales from States Not Imposing a Sales Tax: For remote sales by sellers located in states without a sales tax into non-clearinghouse states, remote sellers are only required to report the buyer's name, address, and the amount of the sale to the clearinghouse but is under no obligation to collect and pay the tax. However, if the destination state participates in the clearinghouse, the seller must collect a tax using an "alternate base" and the single destination state tax rate. The "alternate base" is based on the state where the seller had the most gross receipts (excluding those states without a sales tax). The alternate base must be used because the taxability of a transaction is typically determined based on the seller's location.

Remote Sellers Located Outside of the United States: Remote sellers located outside of the United States must collect and remit a sales tax only if the remote seller's country imposes a value added or other consumption tax on U.S. remote sellers conducting business in the other country.

Other Notable Provisions of the Discussion Draft: The draft contains the following list of circumstances that cannot be used to find that remote sellers have a physical presence in a state:

- Computer software the remote seller leases or owns in a state;
- Inventory of the remote seller valued under $100,000 or held in the state for fewer than 30 days;
- Click-through provisions (*see* Section 4.4, above); and
- A remote seller's presence in a state for less than 15 days.

The draft also removes the protections of the federal Tax Injunction Act, which would allow taxpayers wishing to attack an assessment under the proposed law to invoke the federal courts' jurisdiction unless the taxpayer wishes to challenge taxes it collects in its origin state. In such a circumstance, the Tax Injunction Act would still preempt federal jurisdiction. Rep. Goodlatte's draft also limits states' ability to audit remote sellers and requires the clearinghouse to safeguard any records that remote sellers send to it as mandated by the proposed law.

E. 2017 Proposals

Mobile Workforce State Income Tax Simplification Act (H.R. 1393)

Although not directly related to internet sales and use taxes, the Mobile Workforce State Income Simplification Act of 2017 was introduced in the House on March 7, 2017. Under this bill, a state cannot require withholding and payment of personal income taxes unless it is: (1) the state of the employee's residence; and (2) the state within which the employee is present and performing employment duties for more than 30 days during the calendar year.

The Act would not apply to professional athletes or entertainers and certain other public figures. It also clarifies that being "present in a state for a day" means that the employee performs a preponderance of his or her duties in that state during such day. If the employee performs material duties in both a resident and nonresident state during the same day, the duties are considered performed in the nonresident state.

The House passed H.R. 1393 on June 20, 2017, and has 60 co-sponsors in the Senate as of this writing. Similar legislation has been introduced in previous sessions of Congress and was passed by the House in 2012 (H.R. 1864, 112th Congress) and September 2016 (H.R. 2315, 114th Congress).

No Regulation Without Representation Act of 2017 (H.R. 2887)

The No Regulation Without Representation Act of 2017 (H.R. 2887), introduced June 12, 2017 provides that "to the extent otherwise permissible under Federal law, a State may tax or regulate a person's activity in interstate commerce only when such person is physically present in the State during the period in which the tax or regulation is imposed."

The proposal would prohibit states from telling out-of-state businesses how to make or dispose of their products and from imposing income tax or sales tax collection burdens on remote sellers.

Marketplace Fairness Act of 2017 (S. 976)

The Marketplace Fairness Act of 2017, introduced April 27, 2017, would authorize each member state under the Streamlined Sales and Use Tax Agreement to require all sellers that do not qualify for a small-seller exception (less than $1 million in annual remote sales) to collect and remit sales and use taxes with respect to remote sales under provisions of the agreement, if the agreement includes minimum simplification requirements relating to the administration of the tax, audits, and streamlined filing.

The proposal defines a "remote sale" as a sale of goods or services into a state in which the seller would not otherwise be required to pay, collect, or remit state or local sales and use taxes but for the Marketplace Fairness Act. The bill also delays states from implementing its provisions until at least one year after its enactment.

Remote Transactions Parity Act (H.R. 2193)

The Remote Transactions Parity Act, introduced April 27, 2017, would authorize Streamlined Sales and Use Tax Agreement member states to Agreement to require all sellers that do not qualify for a small-seller exception to collect and remit sales and use taxes with respect to remote sales under provisions of the agreement, if the agreement includes minimum simplification requirements relating to the administration of the tax, audits, and streamlined filing. Additionally, states that have not adopted the Streamlined Sales and Use Tax Agreement must adopt and implement minimum simplification requirements for the administration of sales and use taxes in order to require the collection of such taxes.

The proposal features a phased-in implementation: a state may only require collection of taxes if the seller either uses an online marketplace to make sales or has greater than $10 million in sales in the first year after the effective date, $5 million in the second year, or $1 million in the third year. Enforcement is also delayed until at least one year after the act is adopted.