

COST Scorecard on the States' Sales Tax Systems

NCSL Executive Committee Task Force on State and Local Taxation

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Impact of *South Dakota v. Wayfair*

- The Court noted that South Dakota's law was designed to prevent discrimination against or undue burdens upon interstate commerce
- Importantly, the Court noted three features about South Dakota's law that provides a guide for other states to follow to obtain remote seller collection authority and minimize protracted litigation:
 - Transactional Safe Harbor
 - No retroactive application; and
 - **Membership in the Streamlined Sales and Use Tax Agreement (SSUTA)**
- This Task Force in June unanimously passed a resolution for the states to consider not starting remote seller collection as a result of the *Wayfair* case until 1/1/2019

Impact of *South Dakota v. Wayfair*

- **Specific Items Noted in *Wayfair* Decision Related to Streamlined Sales Tax:**
 - **Standardizes taxes to reduce administrative and compliance costs**
 - Addressed in COST's Sales Tax Systems Scorecard
 - **Single state level administration**
 - Addressed in COST's Sales Tax Systems Scorecard
 - **Uniform definitions of products and services**
 - SSUTA membership addressed in COST's Sales Tax Systems Scorecard
 - **Simplified tax rate structures**
 - Addressed in COST's Sales Tax Systems Scorecard
 - **Access to “sales tax administration software paid for by the state”**
 - Vendor Compensation & SSUTA membership addressed in COST's Sales Tax Systems Scorecard
 - **Audit protections**
 - False Claims & Class Action Suits addressed in COST's Sales Tax Systems Scorecard

State Remote Seller Collection Versus Efficient and Fair Sales Tax System

- While the U.S. Supreme Court overturned the longstanding *Quill* precedent in the *Wayfair* case, **attaining a level of sales tax simplification and uniformity that satisfies a constitutional “commerce clause” requirement should not be confused with constructing an efficient and fair modern-day sales tax system.**

Background on COST's Scorecards

- **Purpose** of Scorecards is to grade the state tax systems on an objective basis and to work with the states' policy makers – both executive and legislative – to improve state and local tax administration for multijurisdictional businesses.

COST's Scorecards

- **State Administrative Scorecard**
 - Increase in independent tribunals & appeal period from 30 to 60 days
- **Unclaimed Property Scorecard**
 - Increase in states exempting gift cards and b2b transactions
- **Property Tax Administration Scorecard**
 - International and improvement of some states appeal processes
- **Sales Tax Systems Scorecard**
 - The Best & Worst of State Sales Tax Systems: COST Scorecard on Sales Tax Simplification, Uniformity and the Exemption of Business Inputs
 - First Edition released April, 2018

All Scorecards are Publicly Accessible on COST's Website: WWW.COST.ORG

States' Sales Tax Systems Scorecard Categories

- **Scorecard Categories**

- Exemption for Business-to-Business Transactions
- Fair Sales Tax Administration
- Centralized Sales Tax Administration
- Simplification & Transparency
- Reasonable Tax Payment Administration
- Fair Audit/Refund Procedures
- Other Issues Impacting Fair Tax Administration

- **Non-SSUTA Categories**

- While the Scorecard incorporates many SSUTA elements, the non-SSUTA items cover about two-thirds of the categories in the Scorecard.

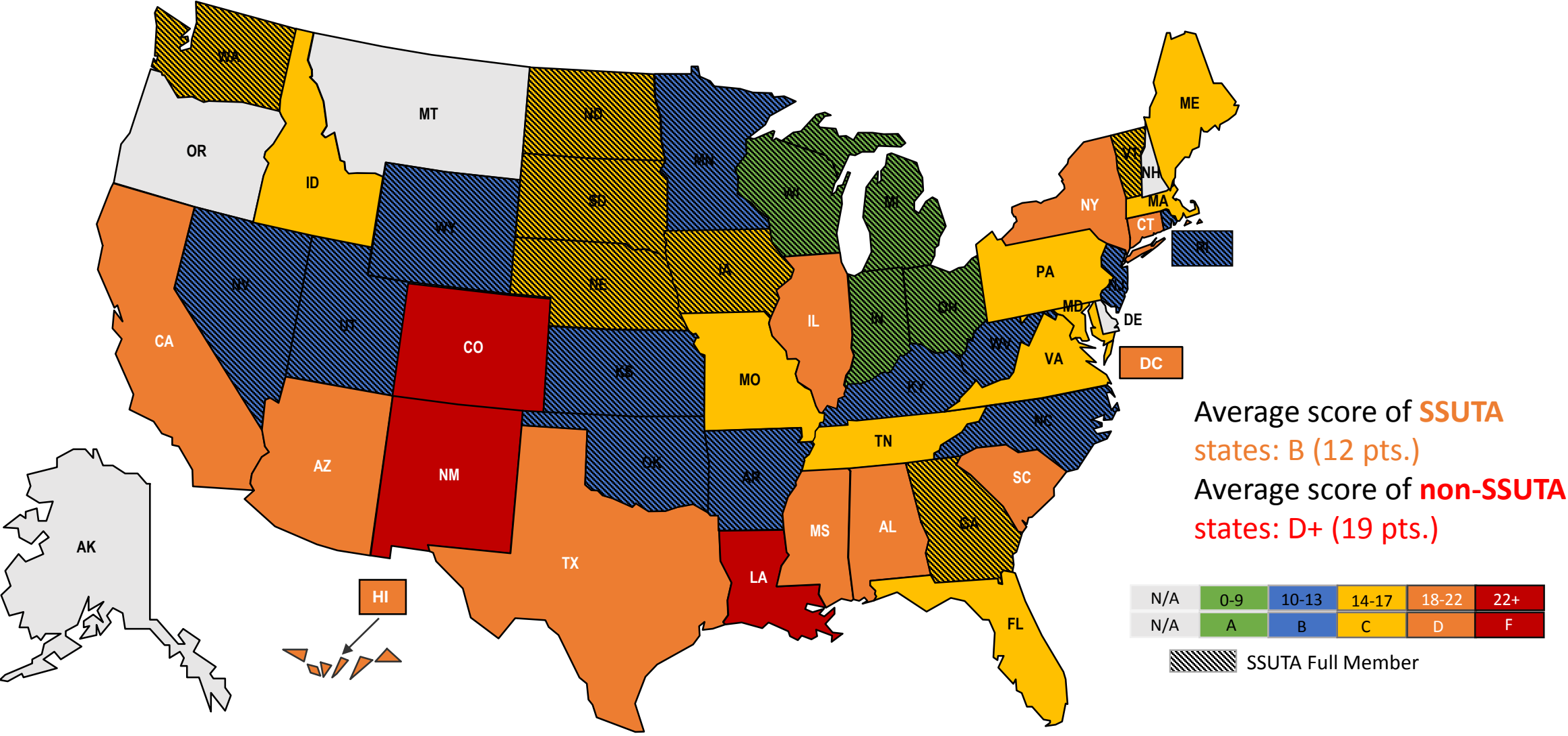
- **What the Scorecard Does Not Grade**

- Tax Rate Differences
- Tax Base Breadth (other than Taxing Business Inputs)

Why Modernizing the State Sales Tax Is Critical to State Tax Policy

- **General sales taxes account for over 32 percent of all state taxes** – and along with personal income taxes – are the largest sources of state tax revenues.
- **The U.S. state and local sales tax system is one of the most complex and inefficient consumption tax systems in the world.**
 - **Exemption of Business Inputs:** Unlike the U.S. states where sales tax on business inputs account for 42 percent of all sales taxes collected, virtually all other countries mitigate pyramiding of their consumption tax by providing more expansive credits for business inputs.
 - **Uniformity and Simplification:** There is a much higher level of consumption tax uniformity in Europe (harmonization through the EU) than in the United States where the largest states with about two-thirds of the U.S. population have not adopted SSUTA.
 - **Central Administration:** The U.S. states' sales tax system – with 45 state taxing jurisdictions (plus D.C.) and over 10,000 state and local taxing jurisdictions – is the most decentralized consumption tax system in the world.
- **The stakes are high:** state efforts to significantly broaden the sales tax base to tax the growing services sector continue to founder because of business opposition to the pyramiding of sales tax on business inputs and the overall complexity of sales tax compliance. The sales tax base as a share of personal income is currently only about two-thirds its 1970 level.

Overall Scorecard Grades: SSUTA vs. Non-SSUTA States

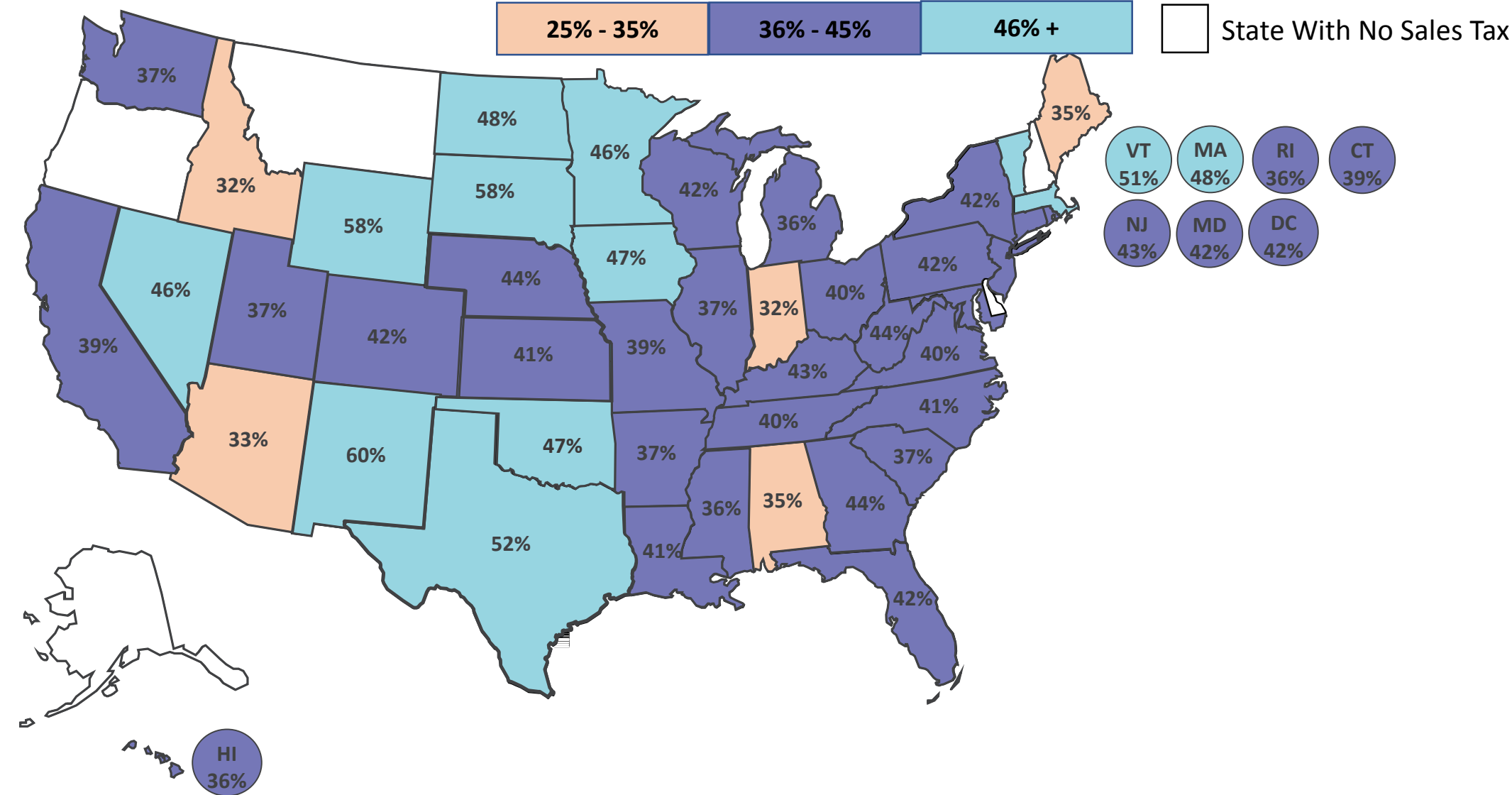


Exemption for Business-to-Business Transactions

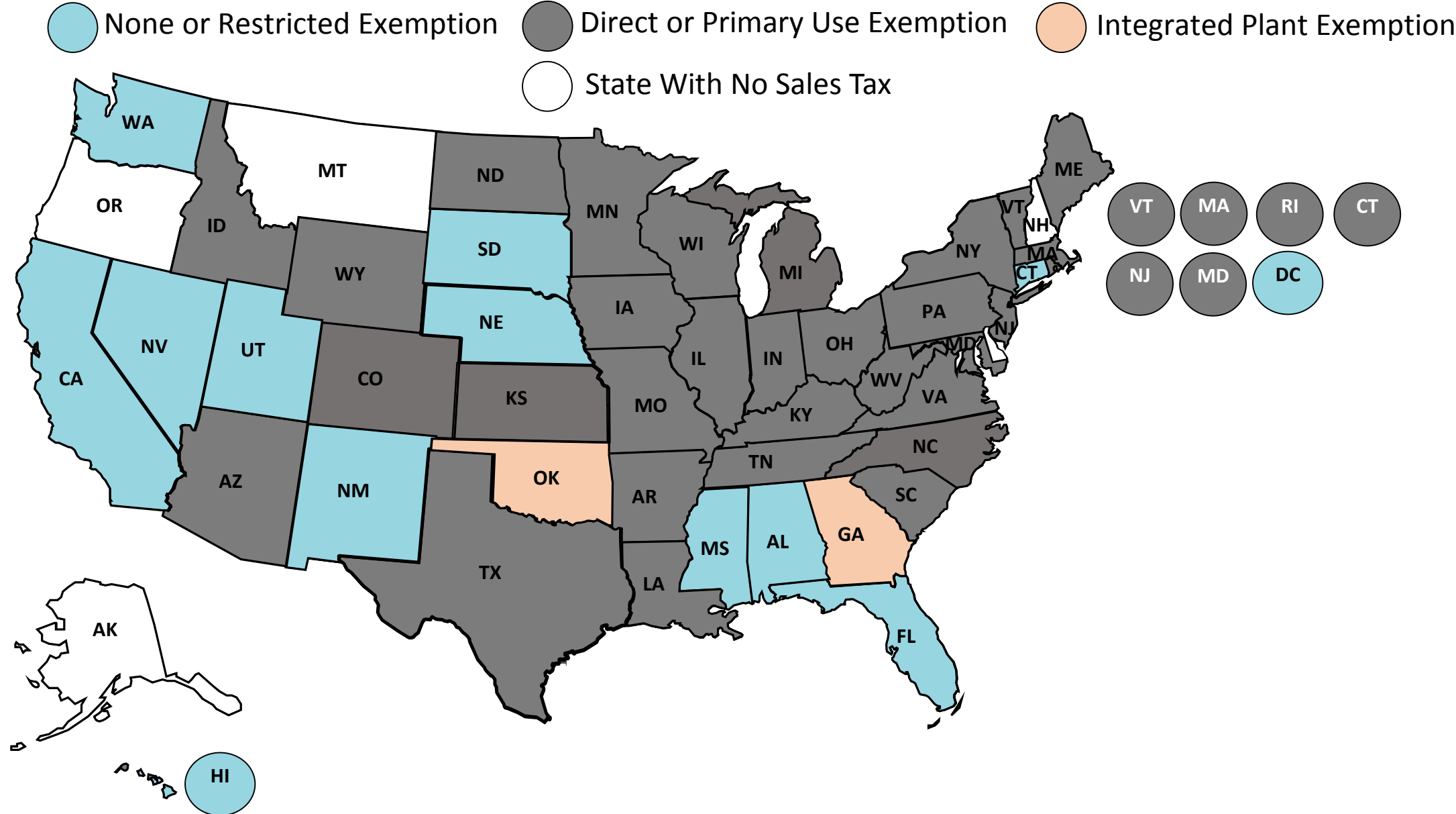
- COST/EY Study highlighting overall tax on business inputs – 2 points
- Manufacturing exemption – 3 points
 - Manufacturing equipment exemption – 2 points
 - Manufacturing inputs exemption – 1 point
- Pyramiding tax of service industries – 3 points
 - Double tax on equipment to provide service and tax on service when sold to consumers

State and Local Sales Taxes Imposed on Business Inputs

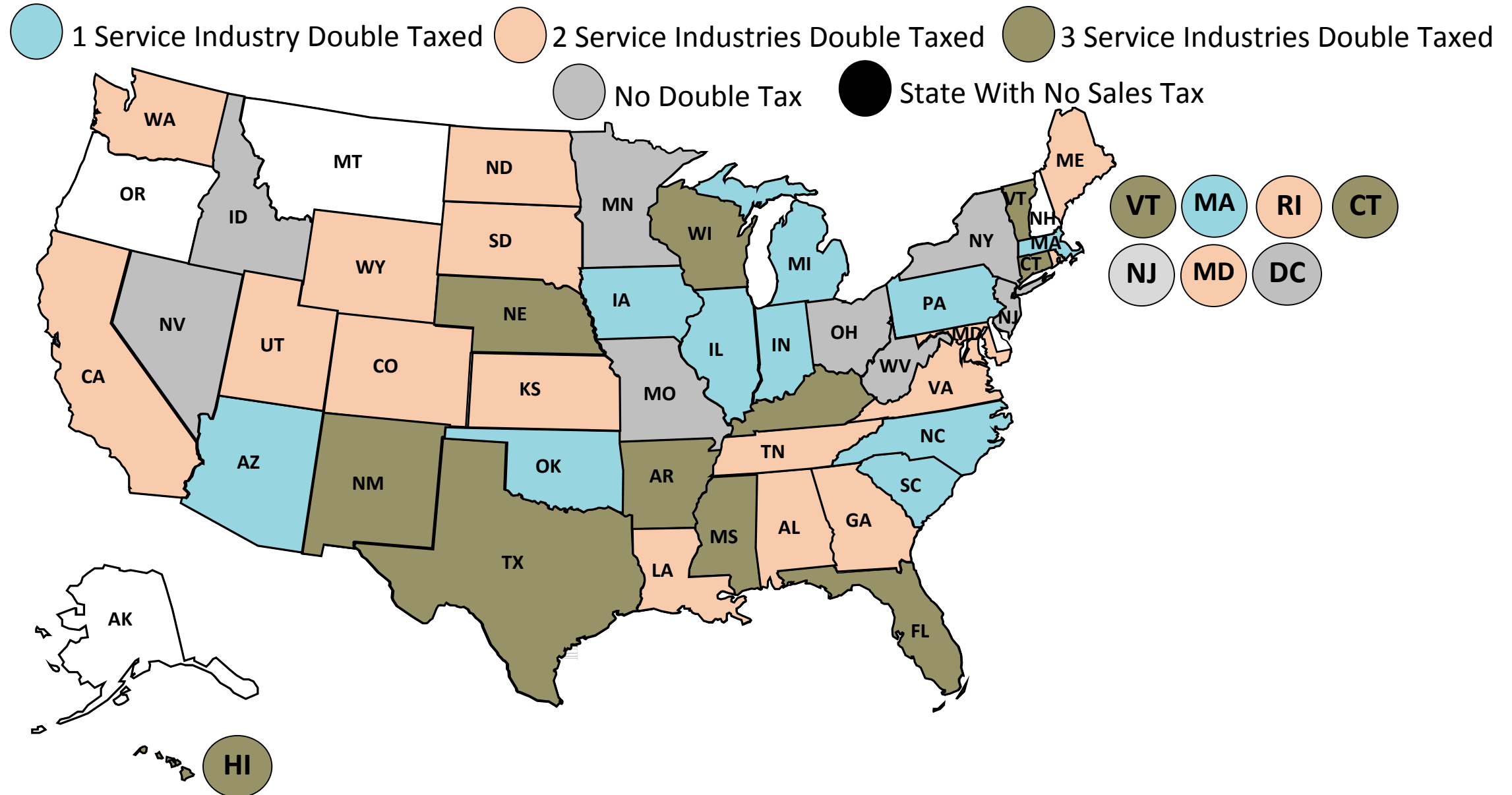
Business Inputs Share of Total Sales Tax Collected



Breadth of States' Manufacturing Equipment Exemptions



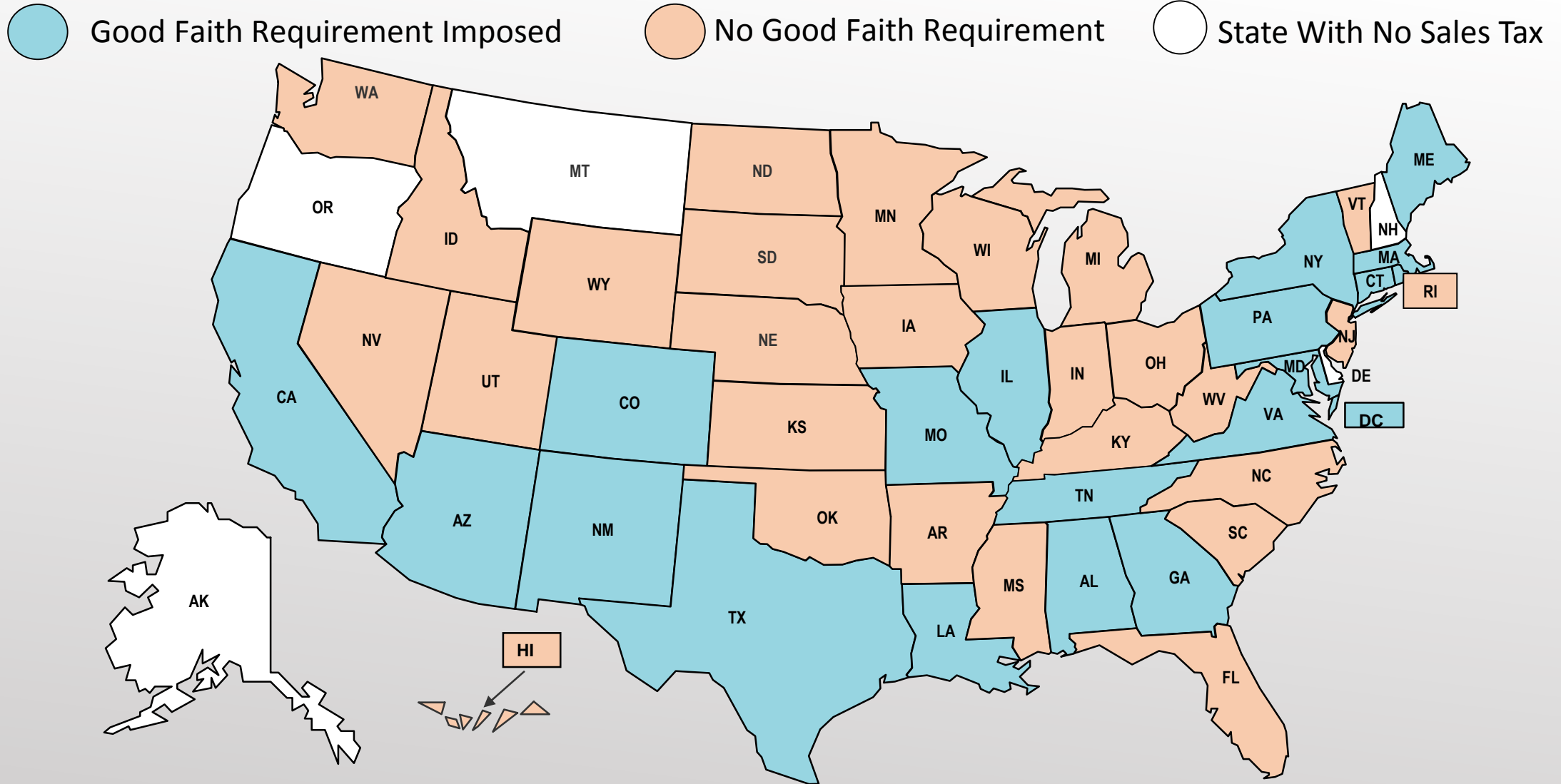
Double Taxation of Select Service Providers: Wired/Wireless, Cable, Electric + Gas



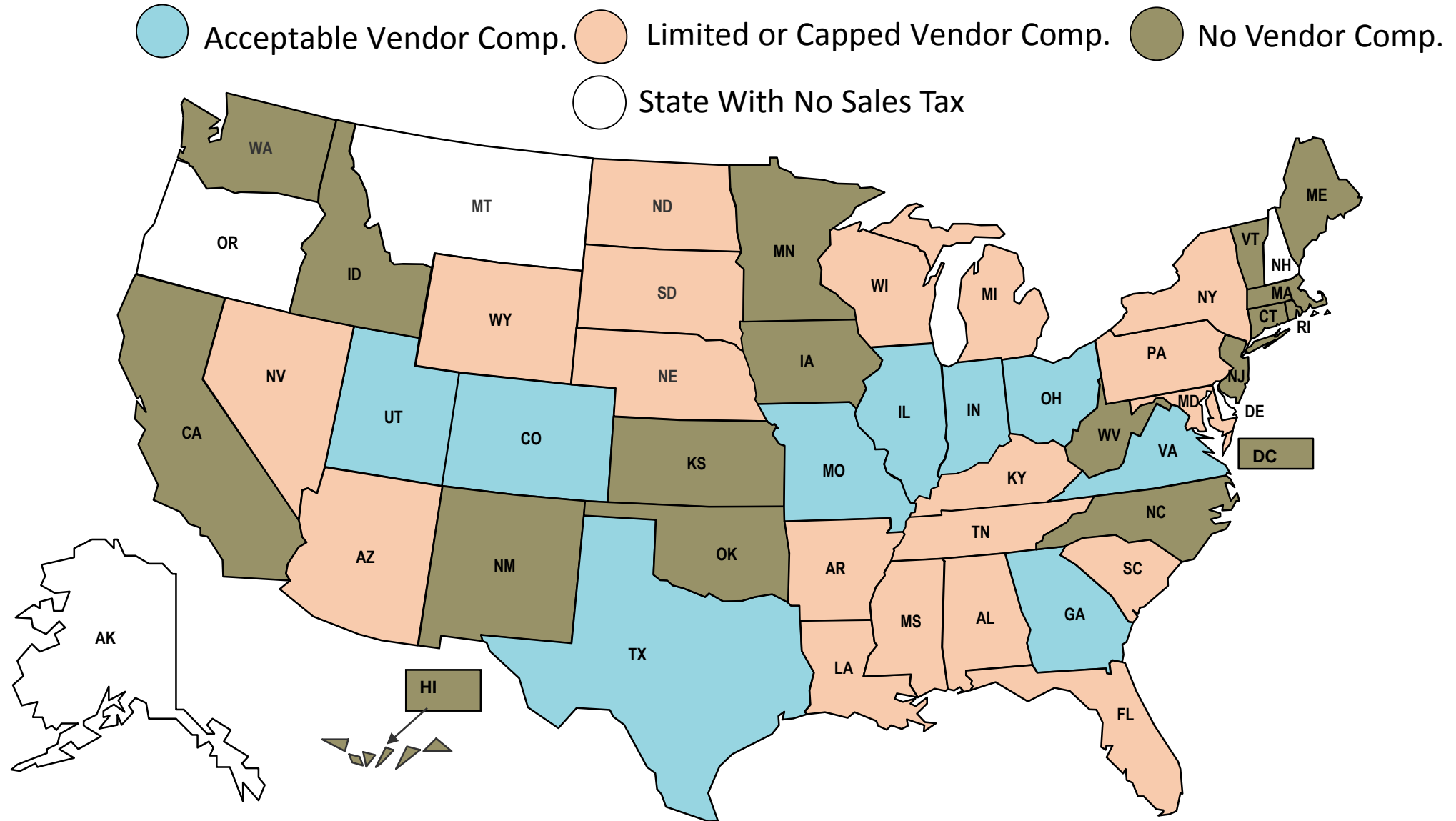
Fair Sales Tax Administration

- Exemption Certificate Procedure - 2 points
 - Good faith on acceptance
 - 120-day period on audit to perfect
 - Allow MTC or SSUTA certificate
 - Verification of exemption/account number
- Vendor Compensation – 2 points
 - No vendor comp. or less than \$12,000 per year (de minimis) - 2 points
 - At least 0.5% for one-rate state or 0.75% for states with local rates – no points
- Broad Direct Pay – 1 point
 - Not overly restrictive – no thresholds over \$1 million per year

Good Faith Requirement



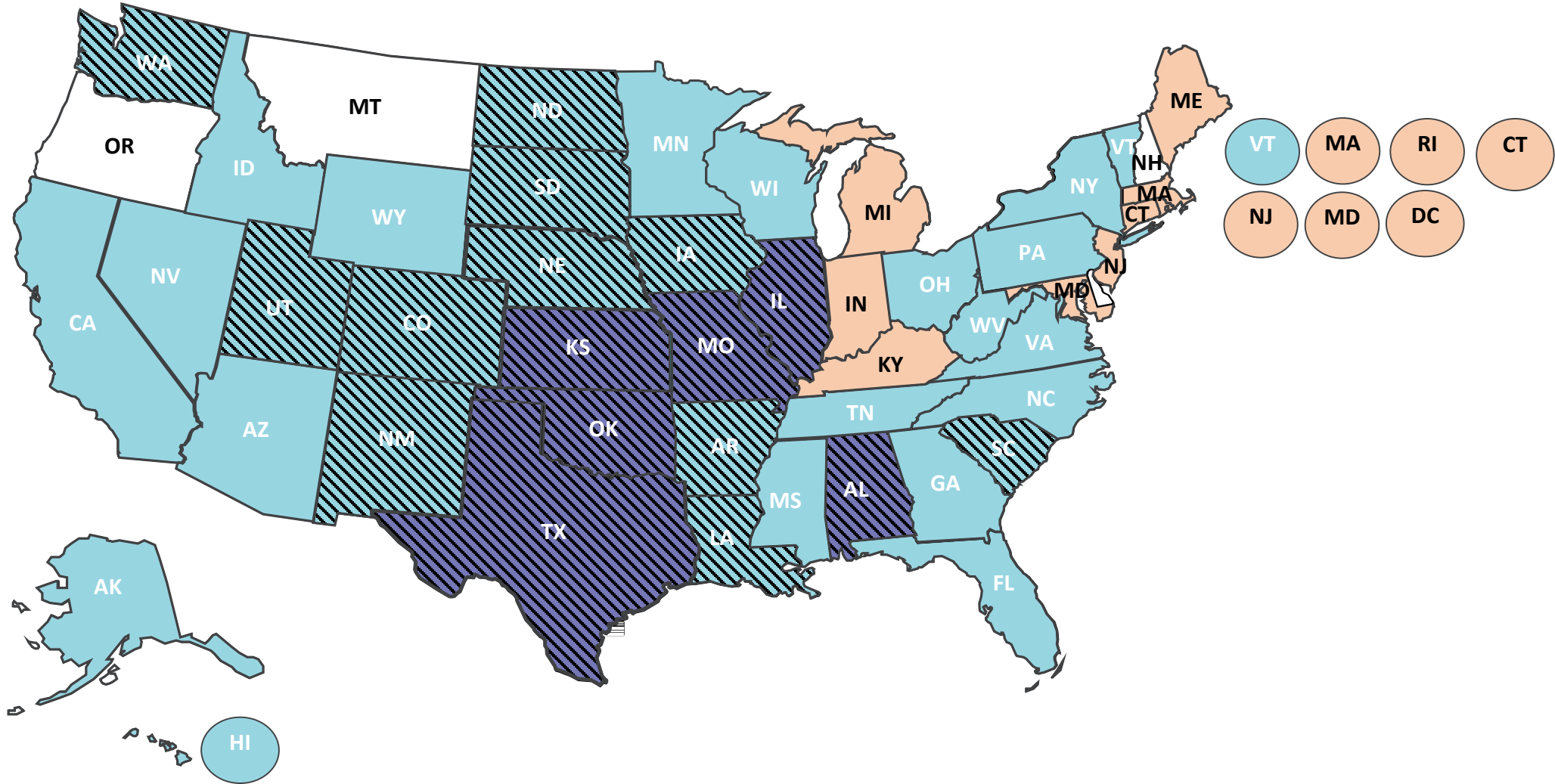
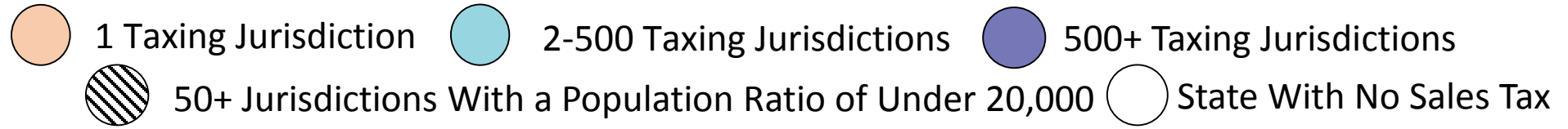
Vendor Compensation



Centralized Sales Tax Administration

- Population of state as compared to number of local jurisdictions - 1 point
 - Less than 20,000 – 1 point
- Central administration – 3 points
 - Uniform tax base
 - Centralized filing and auditing
 - Centralized appeals
- Website has current & historical tax rates and boundaries – 1 point

Number of Taxing Jurisdictions

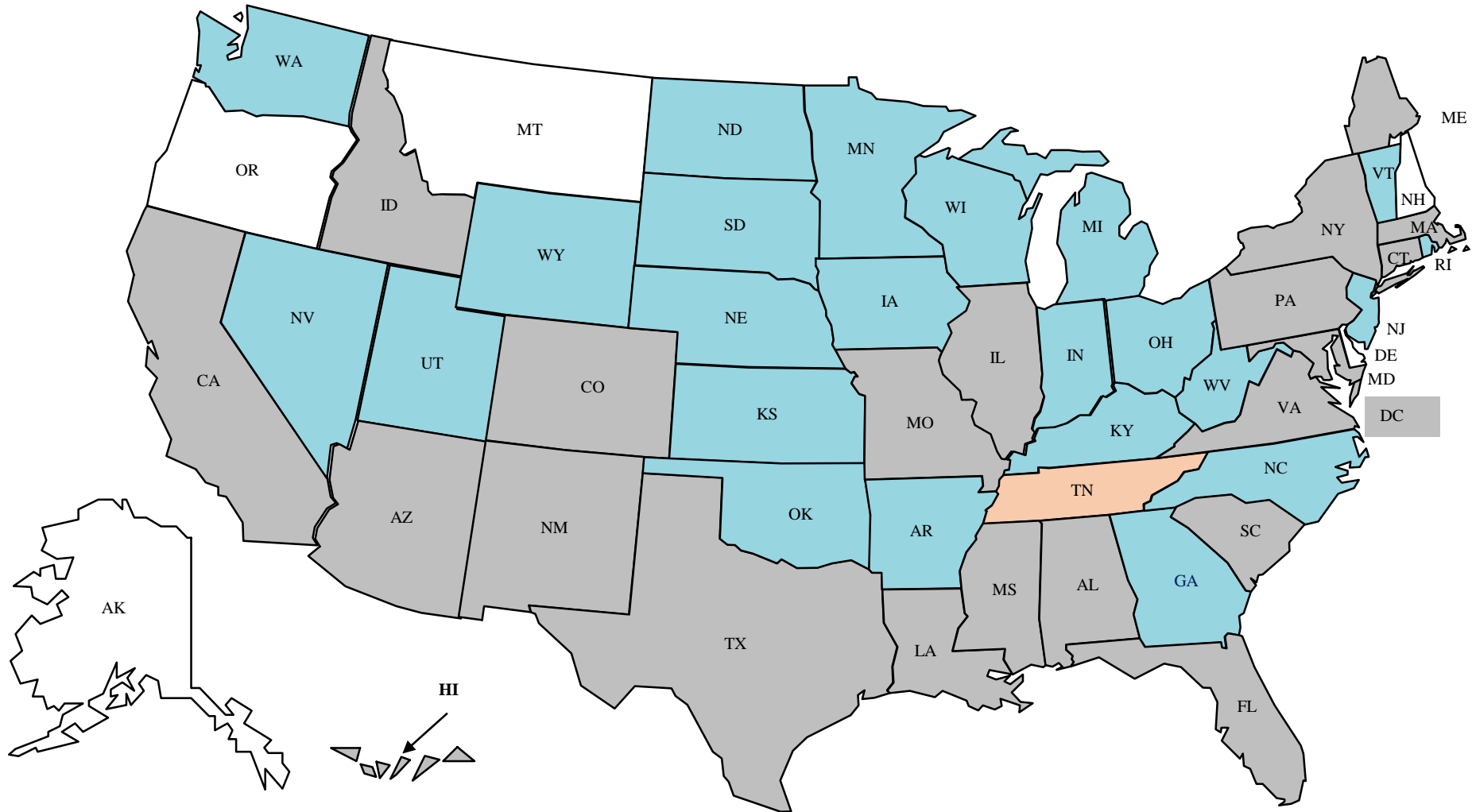


Simplification & Transparency

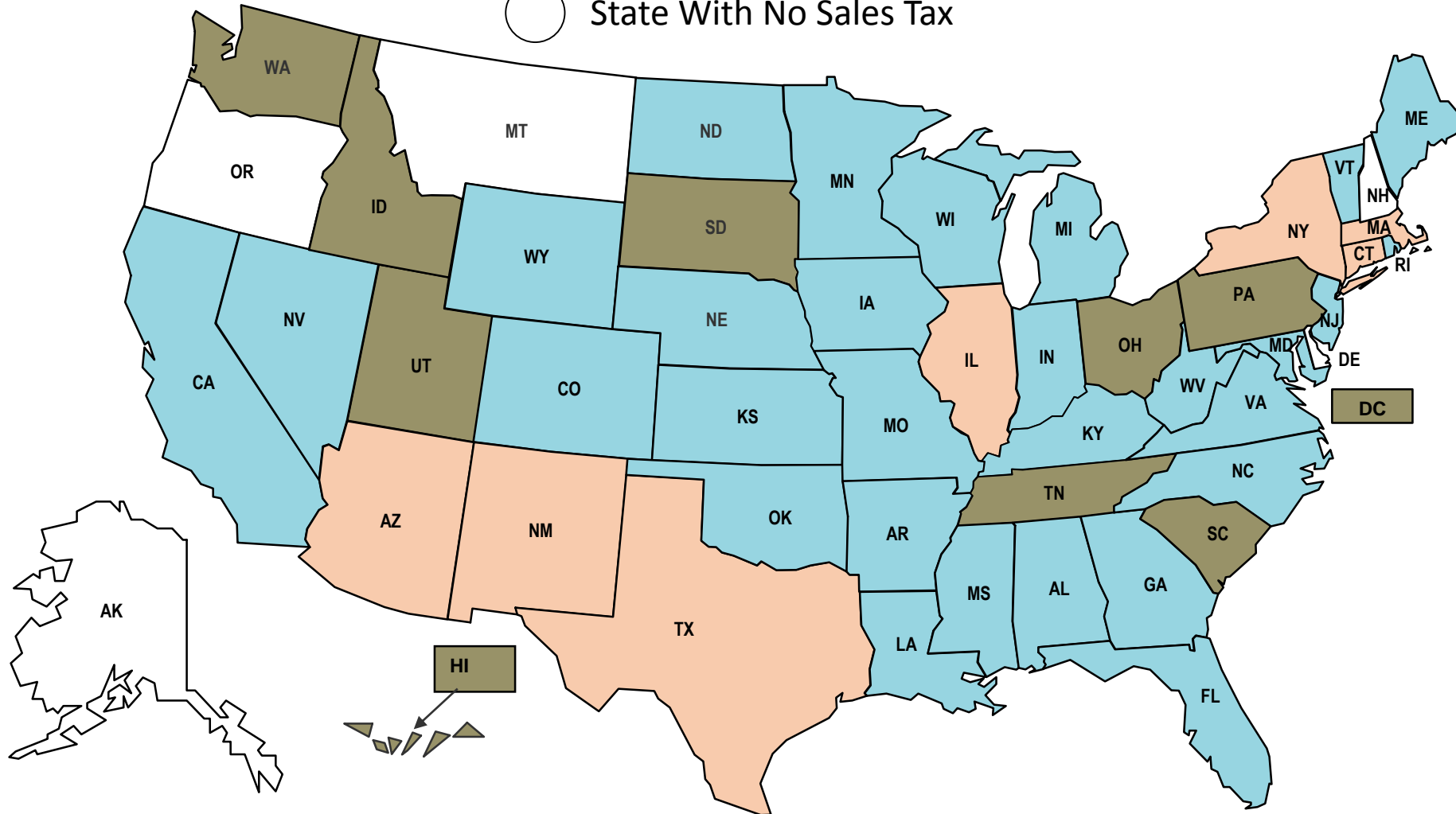
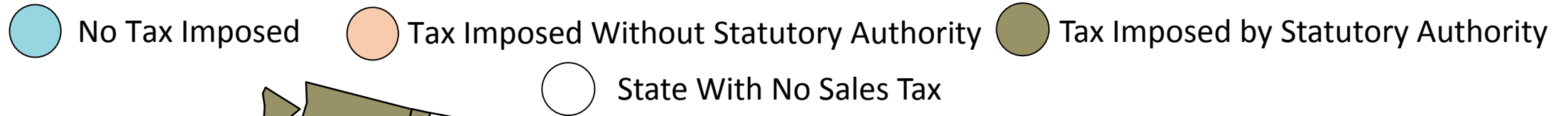
- SSUTA State? - 2 points
- Tax on digital products and prewritten software – 2 points
 - Is by legislation or administrative rule/policy position?
- Liability relief – 1 point
 - Relief should broadly apply to most written correspondence

Streamlined Sales Tax States

● Full Member ● Associate Member ○ State With No Sales Tax ● Non-Member State



Taxation of a Person Merely Accessing Pre-Written Software

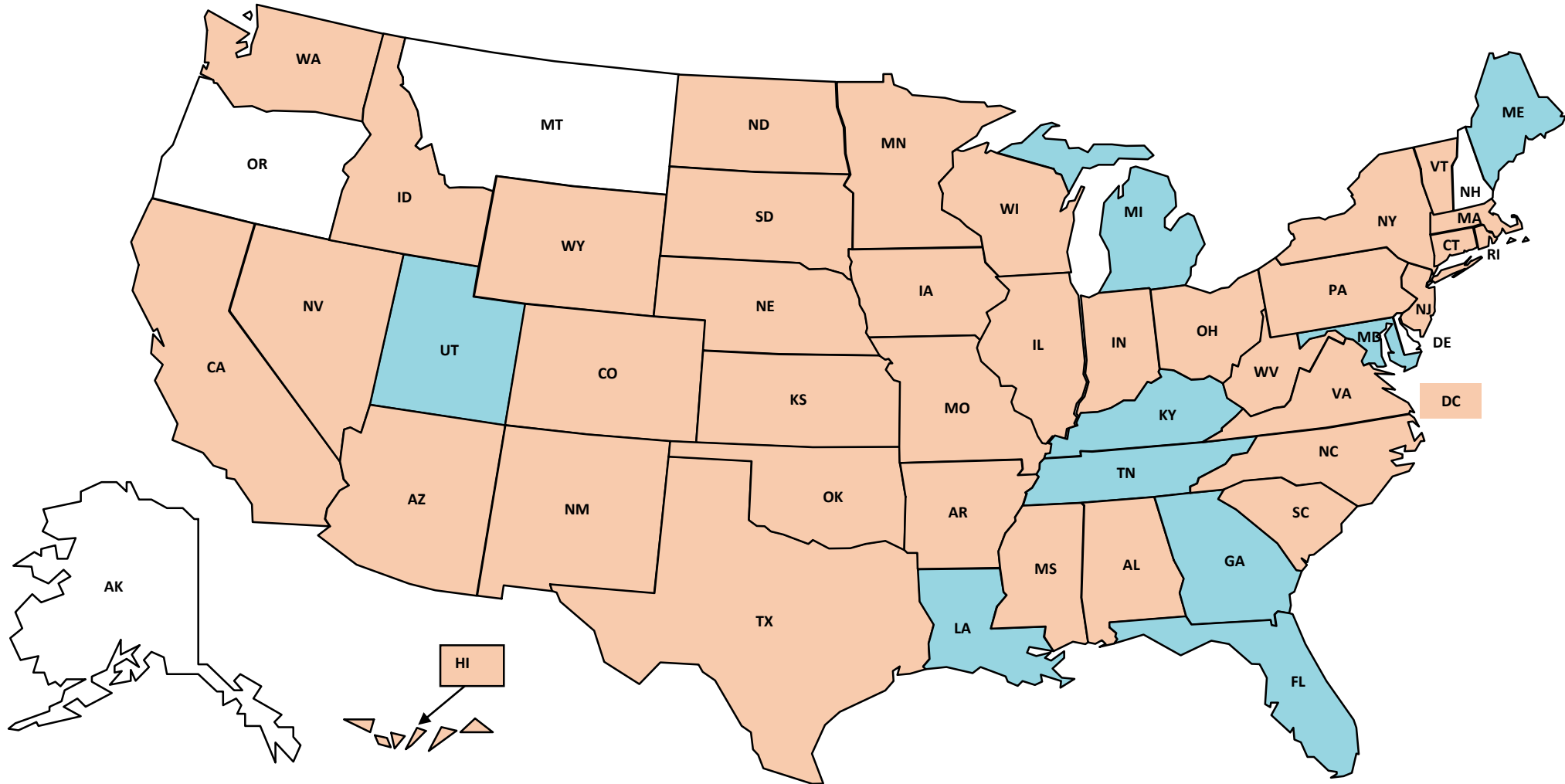


Reasonable Tax Payment Administration

- Advance Payments - 2 points
 - One per year or month – 1 point
 - Two or more per month – 2 points
- Full credit other states sales/use taxes – 2 points
 - Credit sales and use tax – 1 point
 - Credit other states' state and local taxes – 1 point
- Periodic leases tax based on each lease payment – 2 points
 - State accelerating or continuing tax on leases when property no longer in the state – 1 point
 - Credit for tax paid in other states on such leases- 1 point
- Bad debt deduction applies to third-party private label credit card – 1 point

Tax Credit Against Sales and Use Tax

● Credit Only Against Use Tax ● Credit Against Both Sales and Use Taxes ○ State With No Sales Tax

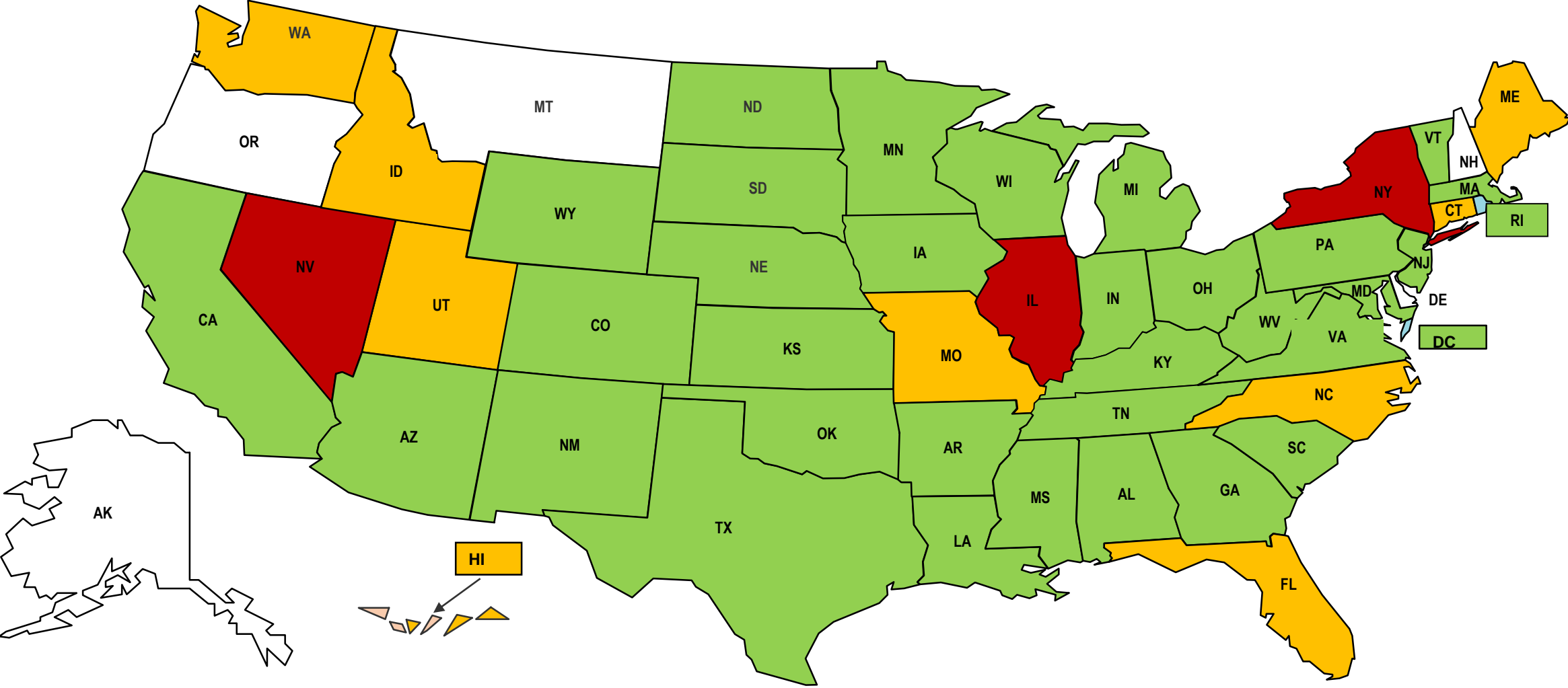


Fair Audit/Refund Procedures

- Purchasers ability to obtain refunds directly from the state - 1 point
- False claims act & class action suits – 2 points
 - Allow either – 1 point each
- Contingent fee or private auditing – 1 point
 - Allow either – 1 point

False Claims Act & Class Action Suits

● Allows Both FCA and Class Action ● Allows Class Action ● No FCA or Class Action ○ No Sales Tax



Other Issues Impacting Fair Tax Administration

States requiring SSNs or addresses on returns:

DC, HI, IN, ND, and PA

States with other issues:

CO – Local nexus issue for intrastate delivery sales

GA – Direct pay permit holders, by regulation, denied interest

IL – Taxpayers being thrown in local tax distribution dispute

LA – “Clean” one penny tax

MA – Real time collection

OH – Onerous employment services tax

Questions

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