

IOWA STREAMLINED SALES TAX ADVISORY COUNCIL

2008 Report to the

IOWA GENERAL ASSEMBLY

January 30, 2009

Council Created; Council Charge

In 2003, House File 683, Section 204 created the Iowa Streamlined Sales Tax Advisory Council. (Please see Appendix A for a list of members as of 12/31/08). The Streamlined Sales Tax Advisory Council was codified in statute at Iowa Code §423.9A in 2006. The Council reviews, studies, and submits recommendations regarding the streamlined sales and use tax agreement.

Meetings

The Council met twice in 2008 with each meeting being held at the Iowa Department of Revenue offices in the Hoover State Office Building in Des Moines. Members may also participate by telephone. Meetings were held on July 31, 2008 and October 1, 2008. Various issues were discussed at these meetings. Copies of 2008 meeting agendas are attached to this report as Appendix B and minutes of the meetings are attached as Appendix C. This information may also be viewed at www.state.ia.us/tax/taxlaw/streamlinedcouncil.html.

Significant Developments

In 2008, the Governing Board addressed the issue of sales tax sourcing as one of the primary inhibitors to states becoming full members of the Project. This topic had been discussed at numerous meetings and Agreement amendments were approved in 2008. The Agreement was amended to provide membership opportunities for states that have origin based sourcing and local sales taxes. The intent of the amendment was to meet the needs of states such as Tennessee, Utah, Ohio and Texas and allow them to pass legislation achieving compliance with the Agreement. The amendments create additional complexity in the Agreement and to date; none of these states has achieved passage of Streamline legislation.

The Governing Board also addressed on a limited basis the issue of vendor compensation. The Small Seller and Vendor Compensation Task Force was created to address the issue. The current compensation model continues to provide compensation to Certified Service Providers for non-nexus taxpayers only.

The federal Streamlined legislation would require expanded vendor compensation. The vendor compensation and small seller issues must still be reviewed and discussed in much greater detail. (See Appendix D for a copy of the Small Seller and Vendor Compensation Task Force 2008 report.) The General Assembly in 2006 requested the Director and the Council to provide recommendations to address the additional administrative burdens sustained by businesses as a result of the State's participation in the Project, particularly destination based sourcing. This request was addressed for Iowa in April 2007 in the Council's report of preliminary recommendations to the Iowa Legislature. See Appendix D attached to the 2007 Report: "ASSISTANCE FOR IOWA RETAILERS AFFECTED BY STREAMLINED SALES TAX".

The Governing Board went through the yearly recertification exercise to be sure member states are in conformance with the agreement. A number of issues were raised regarding the Iowa law. We have responded to the issues and are waiting for further feedback from the Governing Board. Rules are in the process of being drafted to handle some of these issues. There are four delegates to the Governing Board: two from the legislative branch which are Representative Christopher Rants and Senator William Dotzler and two from the executive branch which are Revenue Director Mark Schuling and Revenue Taxpayer Services and Policy Administrator Dave Casey.

As of December 31, 2008, there were 1,148 registrants in the streamlined project. Currently, 131 are model 1 and use certified service providers (CSP), 30 are model 2 and use certified automated systems (CAS), and 987 are model 4 and calculate and submit their own taxes.

There may be legislation required in 2009 to keep Iowa in conformance with the streamlined process and/or to maintain the prior business position of certain industries in Iowa. As noted above, some issues were raised in the recertification process. At this time, there has been no final determination to these issues. Legislation may be required to resolve these issues. Also, the General Assembly should anticipate annual streamlined legislation in the future, similar to annual legislation required to conform Iowa to the Internal Revenue Code.

The Council and the Iowa Department of Revenue participated in national streamlined sales tax meetings and activities. Council members Kristine Magill and Dave Casey participated in all national streamlined sales tax meetings in 2008.

Pending Issues

The Council would like to draw the General Assembly's attention to the following issues as the streamlined process moves forward this year:

- The issue of vendor compensation needs to be addressed at both the state and national level. There continues to be a high level of business concern regarding the lack of progress made on this issue. The Governing Board has initiated review of this issue at the national level in response to mandates in federal legislation.
- The national project has succeeded in creating several "standard" definitions for all states to use as part of a simplified system. The participating states are meeting to develop rules for uniform application. Definitions are already being revisited due to varying interpretations being encountered by member states.
- Workgroups involving the State and Local Advisory Council and Business Advisory Council to the Governing Board continue to meet to address the issue of replacement taxes. Several Governing Board member states have

enacted what appear to be replacement taxes to circumvent provisions of the Streamlined Agreement. This issue has not been successfully resolved yet and is critical to maintaining the integrity of the Project.

- **Direct Mail Issue.** The direct mail issue has become a major focus for the Project. A number of issues must be addressed to handle the various activities associated with direct mail, including taxability of delivery charges and sourcing. Delivery charges are not a major issue for Iowa, since Iowa provides an exemption for delivery charges and delivery charges are defined to include postage, handling, shipping and transportation charges. Sourcing discussions are still in process and may ultimately involve definitions of what is and is not direct mail. Iowa will need to address this issue once it is resolved at the national level.
- **Digital Goods.** The project completed an amendment and rules related to the taxing of digital goods. If a state wants to tax digital goods, such as music or video downloads, the state must specifically impose the tax on the digital goods. Iowa does not have a specific imposition section for digital goods.
- **Software Maintenance Contracts.** The project adopted amendments and rules related to software maintenance contracts. Iowa currently has a statute that covers software maintenance contracts and this statute is consistent with the new amendment and rules.

Statutory Responsibilities Discharged

With submission of this report, the Council fulfills its reporting obligation as charged in Code Section 423.9A. The Council will continue to meet and communicate with the Governor and General Assembly. At the conclusion of 2009, it will file its sixth annual report.

APPENDIX A

IOWA STREAMLINED SALES TAX ADVISORY COUNCIL

Members on December 31, 2008

Kristine Magill, Co-Chair
RSM McGladrey, Inc.
Cedar Rapids, IA

Mark R. Schuling, Co-Chair
Iowa Department of Revenue
Des Moines, IA

Stephen W. Roberts
Davis, Brown, Koehn, Shors & Roberts PC
Des Moines, IA

Andy Warren
NFIB/Iowa
Des Moines, IA

Warren D. Townsend
Wal-Mart Stores, Inc.
Bentonville, AR

David Casey
Iowa Department of Revenue
Des Moines, IA

Jerry Fleagle
Iowa Grocery Industry Association
Des Moines, IA

Jim Henter
Iowa Retail Federation
Urbandale, IA

Marc Michaelsen
Casey's General Stores, Inc.
Ankeny, IA

Ed Wallace
Iowa Taxpayers Association
Des Moines, IA

Ross Larson
Colorfx, Inc.
Des Moines, IA

Dave Krutzfeldt
Interpower Corporation
Oskaloosa, IA

Dick Koberg
Dica Marketing
Panora, IA

Jay Turner
Electrical Engineering & Equipment
Des Moines, IA

Monti Miller
The Learning Post
Des Moines, IA

Ann Stocker
Cargill
Eddyville, IA

Chris Theisen
Theisen's Home-Farm-Auto Stores
Dubuque, IA

APPENDIX B

Streamlined Sales Tax Advisory Council

Agenda for meeting of July 31, 2008 - 10 a.m.

Hoover State Office Building
4th Floor Conference Rooms
Des Moines, Iowa

- I. Welcome & Opening Comments
- II. National Meetings in Washington , DC (March) & Chicago , IL (June)
 - BAC
 - SLAC/Governing Board
- III. Direct Mail
- IV. Governing Board Task Force on Small Seller and Compensation
- V. Update on Legislation & Rules
- VI. Update on Registration & Revenue Tracking
- VII. 2008 Annual Report to the Legislature
- VIII. Future Streamlined Sales Tax National Meetings:
 - A. Annual Meeting in Charleston , WV – September 3-5, 2008
- IX. Set Next Advisory Council Meeting
- X. Adjournment

Streamlined Sales Tax Advisory Council

Agenda for meeting of October 1, 2008 - 10 a.m.

Hoover State Office Building
4th Floor Conference Rooms
Des Moines, Iowa

I. Welcome & Opening Comments

II. National Meetings in Charleston , WV (September)

- BAC
- SLAC/Governing Board

III. Direct Mail

IV. Governing Board Task Force on Small Seller and Compensation

V. Update on Legislation & Rules

VI. Update on Registration & Revenue Tracking

VII. 2008 Annual Report to the Legislature

VIII. Future Streamlined Sales Tax National Meetings

IX. Set Next Advisory Council Meeting

X. Adjournment

APPENDIX C

Iowa Streamlined Sales Tax Advisory Council Meeting Minutes
Hoover State Office Building
July 31, 2008

Present: Mark Schuling, Kristi Magill, Dave Casey, Marc Michaelson, Ann Stocker, and Ed Wallace. Joining the meeting via telephone were Dave Krutzfeldt and Jerry Fleagle. Representatives from the Department were Victoria Daniels, Jeff Aten, and Larry Paxton.

I. Welcome & Opening Comments.

Mark Schuling called the meeting to order at 10:05 a.m. Introductions were made. Mark welcomed Victoria Daniels, supervisor of the Department's Policy Section, to her first Advisory Council meeting. She will be taking on more responsibility in the streamlined sales tax area for the Department.

II. National Meetings in Washington , DC (March) & Chicago , IL (June).

A. BAC

Kristi Magill reported that the DC meeting was an aggressive campaign for national attention. Dave Casey also stated that the primary focus was to allow participants to contact Congressional delegates which will result in more signatories on federal legislation. The feedback was good. Both Kristi and Dave noted that the DC area will be a meeting site again, since it's an election year in 2008 and it will be necessary to reeducate Congress on Streamlined issues.

Workgroups were formed on "Sales Price" (the definition) and "Maintenance Contracts."

Direct mail issues for printers were discussed at both meetings. Issues are not only for printers but anyone using printers.

Kristi reported that the process was started by the Governing Board to sanction New Jersey at the Chicago meeting for being out of compliance with the SSTUA regarding telecommunications. The business industry also believes they are out of compliance regarding the fur tax issue.

B. SLAC/Governing Board

The Governing Board formed a Task Force on the issues involving the small seller exception and vendor compensation based on feedback from the March meeting. Harley Duncan, now with KPMG, will be leading up the "Small Seller and Compensation Task Force." This Task Force is primarily for the federal legislation.

Casey reported that nothing major came out of March or June meetings.

Two amendments reviewed at the Chicago meeting were SSUTA Amendment Sponsorship (AM08003) and Amendment Notice Requirement (AM08004). SSUTA Amendment Sponsorship would allow the SLAC and BAC to sponsor amendments directly to the Governing Board. Amendment Notice Requirement would reduce the SSUTA amendment notice requirement from 60 days to 30 days. The sponsorship amendment was deferred, while the notice amendment passed.

Dave said New Jersey difficulties are results of telecommunications and fur tax issues. This is the first time the Governing Board has had to deal with sanctioning a state. New Jersey has until January 1, 2009, to get legislation passed for both issues.

The Council discussed an amendment sponsored by Washington concerning the origin sourcing of intrastate direct mail. Washington 's amendment provides an election for origin-based direct mail sourcing only for intrastate sales.

Uniform Tax Returns group (Larry Paxton is on this group). Larry reported that CSP's are having discussions regarding everybody using SER (Simplified Electronic Returns). This would be very expensive for Iowa . An alternative which Iowa supports would be to use a state's electronic filing system. This group is still working on uniform returns.

III. Direct Mail.

A handout was provided regarding Direct Mail Delivery Charges.

Kristi mentioned three major issues:

- Sourcing
- Definition of Delivery Charges
- Sales Price

The Council also discussed an Amendment to the Agreement handout. Kristi indicated that the business industry had changes from what was handed out with regard to the delivery charge definition language. Neither BAC or SLAC have come to terms with language to deal with the sales price delivery charge issue – which is a separate issue.

IV. Governing Board Task Force on Small Seller and Compensation.

The Council was provided with a discussion document handout. It was a rough outline resulting from the Task Force's first meeting. The Task Force is in the information gathering stage right now. Representative Rants and Kristi are members of the Task Force. Larry Paxton has been listening in on these teleconferences.

V. Update on Legislation & Rules.

Dave provided an update on membership states. Washington is a full member and that brings the total full-member states to 19. Ohio, Tennessee, and Utah are associate member states. Tennessee's legislation is effective in 2009. Ohio and Utah are very close to full membership with the origin-based sourcing amendment. Wisconsin has legislative issues. Virginia and Texas are in the talking stages. Illinois has origin-based sourcing issues.

Dave indicated that no amendments to the Agreement have been passed this year (2008) that would require Iowa to make legislative changes. After the Charleston meeting we will know if a Streamlined bill will be necessary.

Not much progress has been made in the Department's Streamlined Sales Tax rules. Victoria will be working on a rules project that will include streamlined rules.

VI. Update on Registration & Revenue Tracking.

- 1,100 Registrants
- 38 new businesses registered in July, but that many also dropped off once they realized what they had signed up for.
- 268 filing in Iowa
- \$10.8 million collected this year – FY 2008
- \$9.0 million collected last year – FY 2007

A new CSP (Certified Service Provider) is coming on board July 1, 2008.

Dave reported that the Department was required to recertify to show that we're still in compliance with the Agreement. The Department has completed a certificate of compliance and a new taxability matrix.

VII. 2008 Annual Report to the Legislature.

The Annual Report to the Legislature is due in February 2009. Council members were asked to be thinking about what to include in this year's report as it will be discussed at the next Advisory Council meeting. It was noted to include the vendor compensation to spur discussion.

VIII. Future Streamlined Sales Tax National Meetings:

Annual Meeting in Charleston , WV – September 3-5, 2008

BAC & SLAC are scheduled for Wednesday morning. SLAC continues through Wednesday afternoon.

BAC & SLAC are scheduled for Thursday morning.

Governing Board scheduled for Thursday with a 1:00 p.m. start at the State Capitol followed by a reception/dinner that evening at the Governor's mansion.

Governing Board is scheduled Friday until noon.

The Governing Board is considering only meeting twice (spring and fall) next year. Victoria will be attending more meetings to start transitioning for Dave.

IX. Set Next Advisory Council Meeting.

We'll wait until after the Charleston meeting and probably schedule something around the end of September or first of October with the Council. Diane will send an e-mail.

X. Adjournment.

Mark adjourned the meeting at 11:40 a.m.

Iowa Streamlined Sales Tax Advisory Council Meeting Minutes
Hoover State Office Building
October 1, 2008

Present: Mark Schuling, Kristi Magill, Dave Casey, Ann Stocker, Jim Henter, Steve Roberts and Andy Warren. Joining the meeting via telephone were Ross Larson, Jay Turner and Ed Wallace. Representatives from the department were Victoria Daniels, Larry Paxton and Darwin Clupper.

I. Welcome & Opening Comments

Mark Schuling called the meeting to order at 10:04 AM. Introductions were made.

II. National Meetings in Charleston, WV (September)

A. BAC - Kristi indicated that most topics covered at the BAC meetings are blending with the SLAC topics to be discussed later in the meeting. BAC passed revisions to their by-laws at the Charleston meeting. Kristi commented that Joan Wagnon is running the Governing Board meetings very smoothly and reverting unresolved technical issues back to BAC and SLAC to hash out.

Steve Krantz has taken a job with a law firm in D.C., but will continue to participate in the project. Fred Nicely, formerly of the Ohio Department of Taxation, has replaced Steve at COST. Steve is still the president of BAC.

B. SLAC/Governing Board – Dave updated the Advisory Council on the SLAC/Governing Board meeting discussions on the following topics:

Replacement Tax Issue

A good replacement tax verses a bad replacement tax.

Member states are to visit with their Legislators regarding good vs. bad replacement taxes.

The Governing Board voted on a broad Amendment to the Agreement and passed it with a caveat not to finalize until a rule is drafted by SLAC.

Software Maintenance Contract

Working groups had several meetings and they came up with options. Governing Board voted and passed. Basically allows states to come up with a percentage. The Governing

Board will require a second vote and then draft rules. This should not affect Iowa as the proposal conforms to Iowa law.

SER (Simplified Electronic Return)

Model 1's and Model 2's (CSP's or CAS's) can file SER. Model 4's cannot at this time.

Dave wanted to use our e-file & pay system that we already have in place for Model 4 filers but was told "No."

IDR has created an internal working group to look at the following:

- 1.) Exemption information, i.e., why we collect it and how we're using it. This would be Part II of the SER.
- 2.) SER for other retailers. This would apply to any retailer whether registered under streamline or directly with the State.

The Governing Board passed it for the first time. A required second vote is still to come. IDR doesn't agree that this is a simple conversion as was being sold to the Governing Board.

Sponsorship Amendment

Sponsorship Amendment to SSUTA would allow SLAC & BAC to file their own amendments without a state sponsor. This amendment was voted on at the Governing Board but didn't pass.

Status of States

Dave updated the Council on the status of states. There are 19 Member states and 3 Associate states. The following states having some level of activity:

- Texas - introducing legislation
- Ohio - has legislation
- TN - waiting for 2009 – everything is in place
- FL - has been showing interest
- IL - has some draft legislation

III. Direct Mail

Kristi updated the Council that this impacts almost everyone in business whether you're on the seller side or purchaser side. The Direct Mail Coalition is no longer in existence. Things are now moving in a more positive direction. BAC has a very active Direct Mail Committee focusing on 3 main issues:

1. How to source it
2. How to handle delivery charges
3. Whether or not postage should be included in the tax base

This BAC Direct Mail Committee met with Executive Committee and there is teleconference scheduled for today.

Many states taxability matrix may need to be updated regarding direct mail issues so it's clearer for businesses. Kristi mentioned that Iowa's matrix was not a problem.

Delivery Charges on "business correspondence" - CRIC (Compliance, Review and Interpretation Committee) ruling said it depends on what the state determines it to be whether it's tangible personal property or services. The Council had a lengthy discussion on does it get sourced under Section 310 or 313? If this topic impacts you in anyway, this month is the time to make comments to Kristi.

IV. Governing Board Task Force on Small Seller and Compensation

This Task Force is made up of legislators, the business community and states. Harley Duncan is leading the group and it's a study group in the information gathering stage. They've had several web casts with universities and Amazon. Kristi helped set up a small business presentation and Jay Turner helped with this presentation representing medium-size business owners. Jay took questions and provided insight. This task force will meet face-to-face in November in Chicago.

Amazon presenter, Rich Prim, had an interesting suggestion to simplifying. Rather than seller compensation what if a blended state rate was used for small sellers? Kristi thought this was an interesting idea, but how do you define what a small business is?

V. Update on Legislation and Rules

Iowa recertified in August and updated the taxability matrix. The Executive Board had four issues with Iowa's recertification. The department has responded and CRIC is reviewing. We proposed to address these issues through the rule-making process.

In January, the department will look at amendments passed last year to the SSTUA which may result in a streamlined clean-up bill.

The department is looking at updating our services rules. The Council will have the opportunity to review and comment.

VI. Update on Registration & Revenue Tracking

Larry Paxton updated the Council that streamline has 1,120 registered.

\$1.5 Million was collected for July and August of 2008. That was \$170,000 more collected than for the same period last year.

VII. 2008 Annual Report to the Legislature.

Kristi and Mark will draft the Annual Report and keep the Council informed via e-mail. A teleconference will be held in January to finalize.

VIII. Future Streamlined Sales Tax National Meetings

National meetings will be twice a fiscal year which starts October 1. SST is looking at a May 2009 meeting in the DC area and an annual meeting in September in Oklahoma (home state of the current vice-president of GB). There's talk of the Governing Board meeting in Rhode Island in December.

SLAC will likely be meeting 60 days before the Governing Board meeting. It will also meet prior to the Governing Board Meetings.

IX. Set Next Advisory Council Meeting

The teleconference in January 2009 will be the next Advisory Council meeting.

X. Adjournment

Mark adjourned the meeting at 11:50 A.M.

APPENDIX D

Interim Report

**Small Seller and Vendor Compensation
Task Force**

Including Additional Views From Some Task Force Members

**Streamlined Sales Tax Governing Board, Inc.
4205 Hillsboro Pike, Ste. 305
Nashville, Tennessee 37215**

December 15, 2008

December 15, 2008

The Honorable John Doyle, President
Streamlined Sales Tax Governing Board
4205 Hillsboro Pike, Ste. 305
Nashville, TN 37215

Dear President Doyle:

Enclosed you will find the Interim Report of the Streamlined Sales Tax Governing Board Small Sellers and Vendor Compensation Task Force. The group was formed by the Governing Board to assist it in dealing with two issues:

- whether federal legislation authorizing Streamlined Member States to require remote sellers to collect tax on goods and services sold into the state should contain a de minimus threshold that would exclude certain sellers from the collection requirement and, if so, how might the threshold be fashioned; and
- providing guidance to assist the Board with the responsibility that would be imposed on it by proposed federal remote sales legislation to evaluate whether Member States are providing reasonable compensation to vendors for the costs they incur in collecting state and local sales tax.

The Task Force did not attempt to specify precisely at what level a small seller threshold should be set or to establish firmly the parameters of what would constitute reasonable compensation. Instead, it focused on gathering available evidence relevant to the two issues, identifying questions that the Board would need to address as it pursued the issues, and establishing a framework for the Board to utilize in attempting to arrive at a consensus on the issues. The Report also identifies certain additional simplifications it believes would reduce the burden of complying with state and local sales taxes as well as some areas in which additional work could be done or further information gathered.

We hope you find the Report to be of assistance. The members of the Task Force have appreciated the opportunity to work with you and the Governing Board on this matter, and they stand ready to provide additional assistance should you so desire.

Sincerely,

Harley T. Duncan
Chairman

Members of the Task Force

Harley Duncan, Chairman
KPMG LLP

Rep. Pete Anderson
Wyoming

Michael Bailey
City of Reston, Washington

Sen. Dwight Cook
North Dakota

Richard Dobson
Kentucky Department of Revenue

Roger Geiger
National Federation of Independent
Business

Rep. Wayne Harper
Utah

Rep. Ross Hunter
Washington State

Caroyln Iafrate
Industry Sales Tax Solutions, LLC

Jerry Johnson
Oklahoma Tax Commission

Sen. Luke Kenley
Indiana

Kristi Magill
RSM McGladrey Inc.

Christopher Morris
West Virginia Tax Department

Rep. Christopher Rants
Iowa

Rory Rawlings
Avalara, Inc.

Maureen Riehl
National Retail Federation

Joseph Vandevender
Indiana Department of Revenue

Joan Wagnon
Kansas Department of Revenue

Wayne Zakrzewski
JC Penney Co.

Interim Report
Small Seller and Vendor Compensation Task Force
Streamlined Sales Tax Governing Board
December 15, 2008

Introduction

Charge to the Task Force

The Streamlined Sales Tax Small Seller and Vendor Compensation Task Force was created by Streamlined Governing Board President Joan Wagon in June 2008. The Task Force was created to assist the Board with two issues in federal legislation¹ that has been introduced that would authorize states, under certain conditions, to require remote sellers to collect state and local sales taxes on goods and services sold into the state.

Small Seller Threshold. The federal remote sales legislation provides that a seller would not be required to comply with the terms of the bill (i.e., collect in qualified states even though it does not have nexus as defined under current law) if :

- (1) the seller and its affiliates collectively had gross remote taxable sales nationwide of less than \$5,000,000 in the calendar year preceding the date of such sale; or
- (2) the seller and its affiliates collectively exceed the \$5,000,000 threshold of this subsection, but the seller individually has less than \$100,000 in gross remote taxable sales nationwide.

The threshold is presumably intended to insure that those sellers required to collect have the capacity to comply with the obligation as well as insuring that inordinate resources are not expended by either the seller or the states to collect a relatively small amount of tax.

In recent years, there has been a substantial difference of opinion about the threshold. Some parties believe the threshold should be substantially less than \$5 million while others argue that it should be significantly higher. This disagreement has been an impediment to progress on the legislation. More recently, there has been discussion of assigning the task of establishing the small seller threshold to the Streamlined Governing

¹ Throughout the report, references to ‘federal legislation’ should be read to refer to H.R. 3396 and S. 34 as introduced in the 110th Congress. Generally speaking, the legislation would authorize states to require a remote seller to collect state and local sales and use taxes on goods and services sold into a state if the state is a member of the Streamlined Sales and Use Tax Agreement, if the Agreement is operational, if the Agreement complies with the terms of the legislation and if the seller’s sales volume exceeds a specified ‘small seller threshold’ -- \$5 million in ‘gross remote taxable sales’ in the bills introduced in the 110th Congress.

Board. The Board directed the Task Force to undertake a review and analysis of the issue that would aid the Board in discharging this potential duty as well as to aid all parties in preparing for the 111th Congress.

Vendor Compensation. The federal remote sales legislation also provides:

As of the day that authority to require collection commences under section 4, each Member State shall provide reasonable compensation for expenses incurred by a seller directly in administering, collecting, and remitting sales and use taxes (other than use taxes on goods and services purchased for the consumption of the seller) to that Member State. Such compensation may vary in each Member State depending on the complexity of the sales and use tax laws in that Member State and may vary by the characteristics of sellers in order to reflect differences in collection costs. Such compensation may be provided to a seller or a third party service provider whom a seller has contracted with to perform all the sales and use tax responsibilities of a seller. [H.R. 3396, Sec. 7(a)(14)]

The Streamlined Agreement does not currently address the issue of vendor compensation.² The manner in which the Board will address the issue is still subject to discussion. It appears from the legislation that the Streamlined Agreement will need to be amended to speak to what constitutes reasonable compensation and that the Board will have to evaluate the compensation systems of each member state to assess its reasonableness (and its compliance with terms of the Agreement) on an ongoing basis.

Approach of the Task Force

The Task Force undertook its work in four phases:

- The first effort was to ensure that the Task Force understood the nature of the issues involved, its charge from the Governing Board, and the thoughts of the various Task Force members about the issue;
- Based on this discussion, the Task Force identified a number of areas on which it required education and information in order to be able to discharge its duties, and it developed a series of issues or questions it felt would need to be addressed as it deliberated each issue;
- The Task Force then undertook an education program aimed at filling the information gaps it had identified. Through a series of conference calls and discussions, the Task Force heard from the authors of the most recent study of retailer collection costs as well as others that had participated in that effort, experts on various aspects of the retail industry, and representatives of large online sellers. It also held discussions with several retailers about how they

² The Agreement addresses only the issue of the amounts to be paid to ‘certified service providers’ for their work on behalf of volunteer sellers. .

administered their sales tax responsibilities and those parts of sales tax administration they found most burdensome.³

- Finally, the Task Force held a day-long, in-person discussion to address the various issues and questions it had identified and to prepare its report to the Governing Board.

The objective of the Task Force was not to attempt to develop a specific recommendation for each issue, e.g., speaking precisely to what the small seller threshold should be or what constitutes reasonable compensation for any particular state. Instead, the Task Force concentrated on gathering as much evidence as possible on each issue and trying to develop a framework for addressing the issues. This report is intended to provide a starting point from which the Governing Board can identify relevant information and knowledge gaps, devise a plan to fill those gaps within available time and resources and begin to develop a consensus on the specific approach to each issue.

The Task Force arrived at a number of recommendations regarding the general level of a small seller threshold and vendor compensation as well as some specifics regarding the structure of the threshold and compensation systems. One important point that the Task Force wishes to impress upon the Governing Board is that the two issues need to be considered in tandem. Vendor compensation and a small seller threshold can to an extent act as substitutes for one another. That is, to the extent that vendor compensation can cover all the costs of a remote seller, it could be argued that a small seller can be very low because the seller bears no collection burden. In that situation, the primary determinant of the threshold would be the “break-even” point for the state in terms of the vendor compensation being at such a level it would not warrant pursuing the tax. Likewise, a higher threshold could be considered to reduce the level of vendor compensation required for certain classes of sellers.

Further complicating the necessary decisions is the fact that the level of compensation and any small seller threshold is heavily dependent on the degree to which a seller’s collection and compliance burden can be reduced by additional simplifications or by making proven sales tax compliance technology readily available at low or no cost to retailers of all sizes. The Task Force has made specific comments on desirable additional simplifications as well as ways to foster the availability of technology.

Task Force Recommendations

Small Seller Threshold

The Task Force offers the following recommendations to guide the Streamlined Governing Board in considering the issue of a smaller seller threshold.

The Task Force believes the federal remote sales legislation should provide for a threshold below which a seller would not be required to collect tax in states where it does

³ Copies of presentations and documents prepared for the Task Force are generally available on the Streamlined organization Web site at www.streamlinedsalestax.org.

not have nexus under current law. A threshold is necessary to rationalize the costs and benefits of collection to both sellers and states and to recognize a reality that the smallest sellers cannot practically collect in all states at a reasonable cost relative to the amount of tax they would collect. At the same time, the Task Force believes that sales tax collection is an obligation of doing business and that fundamental fairness requires that, to the extent practical, all sellers should have a collection obligation. At the same time, the Task Force recognizes that many tax laws have exemption levels designed to avoid inordinate compliance burdens for certain taxpayers.

To this point, the Task Force has not attempted to establish dollar-based parameters or limits for what it believes would be an acceptable threshold. Nonetheless, the Task Force believes that over time the threshold should gravitate in the direction of being a threshold that excludes only occasional sales and sellers from the collection requirement. The Task Force believes that proven compliance technology must be readily available and that additional simplifications must be adopted before the threshold can reach such a level. Specific suggestions are made below.

The Task Force believes that any threshold should be plain, simple and straightforward so that a seller can know his/her situation and plan accordingly. As a result, the Task Force recommends that any small seller threshold should be based simply on a seller's gross remote sales⁴ for a specified twelve month period, e.g., the twelve months ending Sept. 30 each year. In addition, once it is determined that a seller has exceeded the threshold, the seller must be allowed a period of time (at least one calendar quarter) to prepare before the collection obligation becomes effective. Likewise, if a seller that is collecting currently falls below the threshold, that seller should be required to collect until the end of the following calendar quarter (presuming that is the time allowed for a seller to prepare for the collection requirement.) The Task Force recommendation differs from the legislation introduced in the 110th Congress. Those based the threshold on "gross remote taxable sales." The Task Force believes that the "taxable sale" requirement adds complexity and uncertainty to the threshold. Some sellers may not know the volume of taxable sales they shipped without collection of tax (or at least would have to take steps to determine if the item was taxable and the purchaser was not exempt.) In addition, a taxable sales requirement increases the burden of any state audits to determine compliance with the threshold.

In determining whether a seller has exceeded the specified threshold, the sales of the seller should be grouped with affiliates in the same line of business (in the same fashion as required in the current legislation) to avoid an incentive for a seller to split its operations among multiple entities in order to stay below the threshold. The Task Force does not recommend an exclusion for individual sellers below a specified threshold even though the affiliated group of which it is a part exceeds the overall threshold. In a similar vein, the Task Force believes the threshold should be a single national threshold and not have a state-level component, i.e., not contain a requirement that would say a seller with

⁴ "Remote Sales" is used here in the same manner as it is in H.R. 3396 and S. 34 as being a sale into a state in which the seller would not be required to collect tax but for the requirement imposed by the legislation.

over X amount of sales in a particular state (where it has no physical presence) would be responsible for collection in that state even though it did not exceed the national threshold.

The Task Force expects that any small seller threshold will be implemented on a phased basis, i.e., the threshold will be reduced over time. Phasing is necessary for two reasons: (a) to allow the Streamlined organization to adjust to and work with the influx of registrants; and (b) achieving a threshold at the ultimate level envisioned by the Task Force is contingent on the adoption and implementation of additional simplifications and increases in the availability of proven technological solutions to a broad range of sellers.⁵

The Governing Board should give consideration to whether sellers making remote sales should be required to certify in some fashion (e.g., via a report filed with the Streamlined Board) that they are below the threshold or whether enforcement of the threshold would be on an “after the fact” audit basis. Requiring some annual certification could be seen as intrusive, but it would allow a seller to think about its position and begin necessary planning as well as putting them in contact with the Streamlined organization so that assistance can be provided.

The Governing Board should review the small seller threshold regularly (at least annually) to determine its effect and operation as well as other adjustments are necessary or warranted in light of changing technology and simplifications.

Vendor Compensation

The Task Force offers the following recommendations to guide the Streamlined Governing Board in the discharge of its duties to evaluate whether Member States are providing “reasonable vendor compensation” as required by the federal remote sales legislation.

The Joint Cost of Collection Study completed by PricewaterhouseCoopers under the direction of a joint business government steering committee in 2006 provides a reasonable benchmark of the costs retailers incur in collecting state and local retail sales tax. The results are consistent with similar previous studies and are believed to provide reasonable results as to the general level of costs and the differential costs among retailers of various sizes. It is also helpful in understanding those factors that drive retailer collection costs. While the Task Force believes that the simplifications incorporated in the Streamlined Agreement have reduced the costs of collection from those measured in the JCCS study, it was not able to evaluate the magnitude of that impact.

The JCCS report does not, however, provide all the information one would ideally like to have in establishing and evaluating compensation systems. As a consequence, the Task

⁵ Some members of the Task Force have suggested that the threshold should be set at a low level and that a higher level of vendor compensation should be required at the outset in order to create incentives for states to pursue the additional simplifications and technology improvements. Such an approach, it is suggested, would align the interests of the business community in greater simplifications with state interests in reducing vendor compensation payments.

Force believes the Governing Board should consider sponsoring additional research work along the lines planned for Phase II of the JCCS work. Any new work should emphasize such issues as the impact of the Streamlined Agreement on collection costs and the impact of differing state sales tax structures on costs of collection. Any new work should also provide for greater segregation of the “large seller” category. In the JCCS study, the large seller category was all sellers with greater than \$10 million in sales; The Task Force believes such a categorization can mask significant differences in collection costs among sellers with just over \$10 million in sales, those with several hundred million dollars in sales and the very largest sellers with billions of dollars in sales. This is especially important given the economies of scale that are present in the costs of collection.

The Task Force adopted the following working definition of “reasonable vendor compensation” in its deliberations.

Reasonable vendor compensation will bear a relationship to the actual costs incurred by retailers in collecting and administering state and local retail sales taxes. Those costs to be evaluated in establishing compensation are those that sellers incur that they would not otherwise incur if they were not required to collect and administer state and local sales taxes.

The Task Force believes it is useful to recognize that certain costs (e.g., the merchant credit card fee associated with the tax component of any retail transaction or the costs of collecting and managing exemption certificates) are incurred only because of the sales tax responsibility while other costs (e.g., certain system and point of sale costs that serve sales tax and other business needs) are mixed in nature and more akin to a “cost of doing business.” There are also certain costs that tend to be fixed and don’t vary based on the amount of tax collected (e.g., cash register costs) while others vary directly with the amount of tax collected (e.g., credit card costs.) Both of these observations need to be considered in evaluating compensation systems.

While it is recognized that what constitutes reasonable compensation will be dependent on a number of factors, the Task Force believes that the Governing Board must provide standards to guide the states in establishing their compensation systems, rather than evaluating each state’s compensation individually within its own context, i.e., the “pornography standard” that says reasonableness will be recognized when it is seen. Subsequent work that gathered sufficient data could be used to develop a model that would aid in identifying a range of expected collection costs given certain characteristics of the state and the seller.

The Governing Board should undertake efforts to identify the drivers of collection costs and undertake steps to reduce those costs. As with the small seller threshold, the Task Force believes it is important to adopt additional simplifications so as to reduce the costs of collection. Similarly, to the extent that Member States make proven compliance technology available to states and pay the costs of that technology, vendor compensation can also be reduced. The Task Force has identified certain simplifications it considers important below.

With respect to technology, the Task Force recognizes that the costs of software licenses and processing transactions reflect only a portion of the overall costs of using compliance technology. As the Task Force learned in its discussions with retailers, integrating tax software into a business's operations can be costly. The Task Force would encourage states and the Governing Board to consider providing a credit to businesses adopting compliance software to offset some portion of the costs of integration.

Consistent with the JCCS study and other similar efforts, the Task Force believes that state compensation systems should reflect differences in the size of retailers, i.e., provide proportionately greater compensation to retailers with a smaller sales volume. The Task Force believes this differentiation is best achieved by varying the percentage of compensation based on the amount of tax collected.

At the same time, the Task Force believes there needs to be further discussion and work on the relationship of various types of collection costs to the amount of tax collected. That is, certain costs (e.g., credit card fees) tend to increase in direct relation to tax collected (at least for credit card sales) while other costs (e.g., cash register programming) serve both sales tax and other business purposes and tend to be fixed costs or at least are not directly proportional to the amount collected. Other costs (e.g., certificate management, audit burden) increase with the size of the retailer, but do not necessarily increase in direct relation to the amount of tax collected. Accounting for these differences in costs, especially as they vary across individual sellers, is not an easy or a precise task within a single compensation system applied to all sellers.

There is a difference of opinion within the Task Force on compensation systems that include a limit on the maximum amount of compensation that a seller may claim in any reporting period as a way to differentiate the amount of compensation paid to retailers of different sizes.⁶ The retail community believes a system that uses an across-the-board limit violates from the reasonable compensation requirement because it does not account for those costs of collection, such as credit card fees, that are not capped and increase as the amount of tax collected increase. States, on the other hand, believe that a system that uses a compensation limit should not be considered *per se* unreasonable. Because of differences in the types of costs involved in administering sales taxes and the variability of those costs across individual retailers, any compensation will likely over-compensate some sellers and under-compensate others. Some states believe an overall limit could be appropriate in certain circumstances. Several members of the Task Force have provided additional views on this subject. Those views are appended to this report.

In evaluating compensation systems, the Board needs to be cognizant of differences in tax rates and their impact on the actual amount of compensation. For example, if collection costs are 2 percent of the tax collected on average and the average rate is 6 percent, a compensation rate of 1.5 percent of the tax collected would yield the same nominal amount of compensation with a 9 percent tax rate. To the extent that certain parts of the costs of collection vary in direct proportion to the amount of tax collected

⁶ Of the 27 jurisdictions that currently provide vendor compensation, 11 of them cap the compensation in some manner. The caps range from as low as \$500 per month to as high as \$20,000 per month. Some states limit the compensation to a maximum amount per location in the state.

(e.g., credit card fees), the cost is going to be 50 percent higher under the 9 percent rate than the 6 percent rate.

The Task Force believes that state compensation systems must reflect the relative complexity of the state's tax structure. To the extent that a state's structure contains elements that inherently add complexity to the collection process, such complexity should be reflected in the level of vendor compensation. In preparing for the JCCS study, the factors with relevance to collection under the Streamlined Agreement⁷ that were identified as adding the greatest complexity were: (a) the existence of numerous local option sales taxes; (b) the degree to which the local option tax rates can vary across local governments; and (c) whether the state's tax system retained origin sourcing for certain sales and destination sourcing for others. The Board should evaluate whether these are still major sources of complexity in light of the simplifications contained in the Agreement.

The Task Force did not consider it important to reflect differences between nexus and non-nexus sellers in the compensation system. Likewise, the Task Force does not recommend that the compensation system reflect differences in the proportion of remote sales among sellers.

The Task Force does not believe that the rate of compensation within an individual state should vary between state tax collected and local tax collected. That is, the compensation rate should be applied to both equally.

The Task Force believes that the issue of reasonable vendor compensation should be reviewed regularly to ensure that determinations reflect the latest data available and all relevant simplifications. It is likely that the Board will need to periodically undertake efforts similar to the Joint Cost of Collection Study.

The Task Force believes it is appropriate to condition the payment of compensation for any reporting period on the timely payment of the tax due and filing of the appropriate return.

Additional Simplifications and Technology

As noted, the Task Force believes that the level of a small seller threshold and determinations on what constitutes reasonable compensation are heavily dependent on the level of simplification achieved through the Agreement. The Task Force believes that the ultimate practical and desirable small seller threshold requires the adoption of additional simplifications beyond those incorporated in the Agreement to this point. Likewise, additional simplifications can allow the level of vendor compensation to be reduced beyond what might be required at this point.

⁷ The JCCS study also identified states in which the local base differs from the state base and states in which local governments administer their sales tax directly as being more complex than others. The Streamlined Agreement, however requires a uniform state and local tax base and state-level administration of all local taxes, so those attributes are not relevant to vendor compensation under the federal remote sales legislation.

Specifically, the Task Force believes the Governing Board should consider simplifications along the following lines in order to achieve a goal of reducing vendor compensation and the small seller threshold.

- Development of a centralized location where state rate and boundary data bases can be accessed online by sellers and the general public and can be downloaded electronically by service providers and others requiring this data.
- Development of an enhanced taxability matrix that consolidates existing state matrices into a uniform matrix, provides additional categories of information (e.g., information on customer-based exemptions) and makes the same available in a useable electronic form.⁸
- Development of a ‘clearinghouse’ or other central utility that would allow a seller or its service providers (CSPs or shopping carts) to file returns and payments for all states with a single entity. This would be the equivalent for returns and payments of the central registration system developed by the Streamlined organization.

In a similar vein, the Task Force believes the levels of vendor compensation and a small seller threshold are significantly dependent on increasing the use of tax compliance software by sellers of all types (particularly smaller sellers) by making the technology readily available at little or no cost to a wide range of sellers. The Governing Board should devote attention to steps it can take to achieve these ends. The Task Force has identified two steps that can assist.

- The Board should establish procedures that would allow private entities to qualify to certify various types of certified service providers. The Task Force believes this could increase the availability of technology providers and that it will be necessary to accommodate the influx of sellers once the federal legislation is passed.
- The Board should consider promoting a tax credit to cover costs associated with implementing compliance software and integrating it with a seller’s current systems. [Discussed further above.]

Additional Information Needs

In its deliberations, the Task Force identified several areas in which further information would benefit the Board’s decision making process. They include:

- While the JCCS Cost of Collection Study provides a meaningful and sound benchmark for evaluating retailer costs, further work in this area will be helpful to the Board and to the states in designing compensation systems. At least five issues should be examined in any work done in this area: (a) the impact of the simplifications currently in the Agreement on the costs as

⁸ Currently, the taxability matrix required by the Agreement is limited to items that are product exemptions for which a definition is developed and included in the “Library of Definitions.”

estimated in the JCCS work; (b) the impact of additional simplifications including, but not limited to, those outlined by the Task Force on costs of collection; (c) the impact of varying tax structures on costs of collection (e.g., local taxes, origin sourcing, etc.); (d) the relationship of various types of collection costs to the amount of tax collected (i.e., are they directly proportional, partially proportional or fixed); and (e) greater segregation of sellers in the over \$10 million category so that the trend in relative collection costs between those just over the threshold and the very largest sellers can be better identified. The Task Force recognizes that such a study will take time and considerable resources. Further, it will require the active support of all groups to encourage sufficient survey response to make valid judgments about the collection costs. If it is determined that another statistical analysis cannot be performed, the Board will still need to attempt to assess the manner in which Streamlined may have reduced collection costs and to better specify the drivers of collection costs so that additional simplifications can be addressed to those areas.

- One of the issues for the Board must face in evaluating small seller thresholds is the impact a threshold will have on potential revenue collections. The Task Force heard from researchers at the University of Maryland suggesting that as much as 40-50 percent of all e-commerce sales are made by as many as 5 million small firms with less than \$1 million in sales annually. While the statistical approach of the study has been determined be sound, a side-product of the study is to suggest that other measurements (e.g., Census Bureau) of the e-commerce market have underestimated the total by as much as 15 percent. In addition, if the e-retailer universe is that fragmented, it stands in stark contrast to fixed-base retailers which exhibit substantial concentration of all sales in the largest firms. Also, the Internet Retailer magazine estimates that the Top 500 Internet sellers accounted for about 60 percent of all Internet sales in 2007. Further clarification of this important issue would be helpful.
- The issue of the credit card merchant fees imposed on the amount of tax collected on credit card sales is an important one.⁹ It is a cost that is solely attributable to the seller's role as a tax collector, it is not in the control of the seller, it will become more important as electronic payments become more prevalent, it increases as the amount of tax collected increases, and it can be a substantial amount for large sellers. There are also some costs associated with other electronic payments such as debit card payments. The Task Force believes further work is necessary to gain an understanding of the relative role of electronic payments among various types and sizes of retailers as well as the distribution of electronic payments across debit cards, credit cards and private or store label cards and the relative costs associated with such payments.

⁹ The issue is this: On a \$100 credit card sale in a state with a 6 percent tax rate, the seller would be responsible for paying to the credit card processor a fee of about 2 percent (or \$.12) on the \$6 in tax collected on the sale.

Additional Views

Views on Vendor Compensation Submitted by Rep. Ross Hunter, Washington State

To: Fellow Members of the Small Seller Task Force

Our legislature is in session this weekend and I consequently regret not being with you in Providence. While I cannot be there in person, I do want to share with you some of my thoughts.

We cannot take caps on vendor compensation off the table. There are both practical and political issues surrounding vendor compensation caps.

Our ability to measure the actual cost of collection is imperfect, but it's clear that without a cap, some sellers may receive far more in compensation than their actual costs. I cannot imagine introducing a bill to do this, nor can I imagine my legislature allowing this.

With the budget problems states are now facing, everyone must act prudently. Allowing sellers an unrestricted stream of state revenue would be viewed by many as imprudent. Just as states cannot do everything they want to support public services, sellers cannot expect the windfall that uncapped compensation could bring.

Aside from the cap issue, I also think we need to be careful about the meaning of "reasonable" compensation. It probably does not mean full compensation for every imaginable cost of collection. Businesses understand that there are many costs they incur over which they have little or no control. To at least some extent they recover these costs through their pricing decisions. There are also many costs where there is likely to be a difference of opinion as to the nature of the particular cost and we need to be able to negotiate this.

Reasonable compensation assuredly must leave room for caps **to be reasonable**.

Views on Vendor Compensation and Small Seller Threshold Submitted by Rep. Wayne Harper, Utah

Two comments and my positions on vendor compensation and small seller exemption.

1. I am keen on a set vendor compensation, which can be scalable based on total retail sales. I support a cap on compensation and rigorous adherence to a compensation based on actual costs to collect and administer, including software solutions that ease and reduce the cost of collection. Any software provided by governmental entities, programming, etc. provided to vendors must be taken into the full equation and must adjust the compensation rate downward.
2. I am of the opinion that there should be a permanent floor for small seller threshold, contrary to where the task force is going. The amount and parameters are still flexible to

me. Phasing in is OK. An annual certification of small or under the threshold level vendors may not be simplification and may be problematic.

Views on Vendor Compensation Submitted by Richard Dobson and Jerry Johnson

In examining vendor compensation, the following points should be considered in whether states should be able to set caps:

- In some cases, the absence of a cap could lead to a seller receiving more in compensation than its actual costs of collection. A cap may be the most practical way to avoid overcompensating a seller.
- Reasonable compensation does not necessarily mean full compensation for every cost of collection. To at least some extent, costs may be passed on. The cost of a point-of-sale system has a sales tax element, but the system also serves other purposes for a seller besides sales tax collection. It would not be reasonable to compensate a seller for the entire cost of the system.
- States need to have a reasonable understanding of the relationship of compensation to revenues. To what extent will new compensation rates offset new revenues anticipated from mandated collections? The timing of implementing compensation and receipt of new collections will be critical as well. A prohibition against caps could make the achievement of that understanding difficult.
- In the foreseeable state budget environment, it is not reasonable to expect that state legislatures will allow for uncapped compensation.
- It is not reasonable to expect states to compensate sellers who do not file returns and remit taxes in a timely manner.
- The use of tiering or a graduated percentage of compensation based upon tax collected represents a more highly complex system of calculation than what most states that provide vendor compensation currently have in place. Replacing current compensation calculations and/or implementing a tiered compensation package will pose programming issues for state filing systems.