

14

WISCONSIN SOFT DRINK ASSOCIATION

2700 S. Shore Drive, Suite A
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Elmer C. Knapp
President

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Sam R. Schmitt
Vice President

November 21, 2000
Sam R. Schmitt

START
FILE

Senator Robert Jauch
Room 313 South, State Capitol
Madison, Wisconsin 53707

Dear Senator Jauch:

The Wisconsin Soft Drink Association respectfully asks you as a member of the National Conference of State Legislatures (NCSL) Executive Committee Tax Force on State and Local Taxation on Telecommunications and Electronic Commerce to oppose the inclusion of a separate definition of "soft drink" in the model law.

Soft drinks are clearly covered by the definition of food and food ingredients in the draft "Model Sales and Use Tax Definitions."

- That definition states that "food and food ingredients" includes "**substances, whether in liquid, concentrated, solid, frozen, dried, or dehydrated form, that are sold for ingestion by humans and are consumed for their taste or nutritional value.**"
- **Soft drinks are liquid substances sold for ingestion by humans and are consumed for their taste.**

Also, because the definitions of "what is" and "what is not" a "soft drink" are now so widely varied across the states, a national uniform soft drink definition will create **winners and losers with respect to tax revenue.** For example, the proposed soft drink definition eliminates fruit juices containing 50% or more natural fruit from the taxable category. This definition might add tax revenue in states like Pennsylvania, which currently does not tax fruit juices with a natural fruit content of over 25%. However, this same definition will likely **cause significant revenue loss in states like California, Texas, Florida, North Carolina, and Wisconsin,** which currently taxes all fruit juice beverages as non-food products if they contain less than 100% natural fruit juice.

While you might expect Wisconsin-based soft drink bottlers and distributors to support a uniform definition of soft drinks that would reduce related tax collections here, we are in most cases ultimately tied to a larger system of production and distribution that would be thrown into chaos by such a definition. As taxes would increase in some states and decline in others, the impact on producers would vary as demand responds to changes in the combined price plus tax. This inevitably leads to adjustments in production, distribution, sales, and jobs, and a risk of further eroding the tax base.

We are told that if a separate definition of soft drinks were not included in the NCSL model, it could not be added later, effectively eliminating the tax on our beverages. Currently, 35 states tax soft drinks, including Wisconsin (17 of these states also tax food). For our industry, however, that means 15 states do not currently tax soft drinks and might be inclined to do so should they adopt the uniform sales tax model. The threat of taxation in these states will bring about significant soft drink industry opposition to the uniform sales tax program. Soft drink bottlers believe that individual states should make their own decisions regarding which products to carve out under the food definition.

Thank you for your consideration of our concerns. Please do not hesitate to contact me should you need further information.

Sincerely,

A handwritten signature in cursive script, appearing to read "Martin J. Schreiber", followed by the initials "MSJ" in a smaller, less legible script.

Martin J. Schreiber
Executive Secretary



State of Wisconsin • DEPARTMENT OF REVENUE

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Date: November 27, 2000
To: Senator Bob Jauch
From: Diane Hardt *DHardt*
Subject: Forrester Research Report

Attached is a report of Forrester Research which reflects very positively on the Streamlined Sales Tax Project. Forrester Research has indicated that "the Streamlined Sales Tax Project is the only viable effort with the ability to preserve state sales taxes." "The Streamlined Sales Tax Project has momentum, wide buy-in, and timing on its side."

This is very good news. This is the first national exposure we have received.

NOVEMBER 2000

Making Net Sales Tax Pay

By Jeremy Sharrard

With John C. McCarthy

Michael J. Tavilla

QUICK VIEW

eCommerce growth exposes deficiencies in sales tax laws. State reforms, Web-based collection technologies, and the changing complexion of online retail will ultimately force retailers to collect taxes on all remote sales.

THE LANDSCAPE

- The Net brings focus to the sales tax debate.
- Efforts to reform sales taxes have emerged on a number of fronts.

ANALYSIS

- The Streamlined Sales Tax Project is at the center of sales tax reform efforts.
- States will gain the ability to collect taxes from remote sellers.

ACTION

- Dot Coms should get their heads in the tax game.

WHAT IT MEANS

- Real-time tax collection will create economic indicators.

ACTION



Traditional retailers should change their tune.

While traditional retailers have helped to forward the efforts of the SSTP, their goal has been more to burden online retailers with onerous tax collection responsibilities than achieving simplification. By coming to the table with this narrow motivation, brick-and-mortar chains risk missing an unprecedented chance to work with governments to reduce tax collection burdens for all sellers. Retailers should invite Dot Coms to the table and both should work with states to create a truly simpler system for collecting taxes. Simpler tax structures mean increased profitability for all retailers.



Dot Coms should pull their heads out of the sand.

Online retailers have been conspicuously absent from sales tax reform deliberations. That tactic may have worked at first, but now that states are organizing to expand collection, Dot Coms should work with -- rather than ignore -- tax reformers. If they remain on the sidelines while traditional retailers help shape tax policies, Dot Coms will find themselves crippled once they are legally required to collect taxes.



Accounting firms should buy tax collecting technology vendors.

Large systems integrators and accounting firms like EDS and Ernst & Young should snap up tax collection technology vendors like esalestax.com or TAXWARE before their price tags go up. Getting involved in tax collection automation will make up for the revenues their tax practices will miss out on once states ease compliance burdens on retailers -- reducing sellers' need for accountants.



Democrats should make the tax issue their own.

Democrats have neither embraced nor distanced themselves from the Internet tax debate. Republicans are divided on the issue -- caught between states' rights and anti-tax leanings. Democrats should endorse the streamlining efforts and push Congress to pass enabling legislation. Though they'll initially face resistance from anti-tax and pro-technology critics, they'll win out if they cast their proposals as eGovernment reform. Plus, they'll garner valuable political capital from appreciative governors -- and fluster Republicans by highlighting an issue that divides them.



By Jeremy Sharrard

With John C. McCarthy

Michael J. Tavilla

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FORRESTER

The Forrester Report

NOVEMBER 2000

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17 RELATED MATERIAL

18 GRAPEVINE

Dad, I can't sleep. Tell me about your tax meeting.
We take it back.
Stupid tax-exemption tricks.
Are tax jokes funny? It depends.

2

THE LANDSCAPE

The Net Brings Tax Debate To The Fore

State governments had given up on going after sales taxes on catalog purchases. But looming revenue losses from eCommerce combined with eroding tax bases have spurred them into action. States are now working together to simplify their sales tax systems in hopes of collecting taxes on all remote sales.

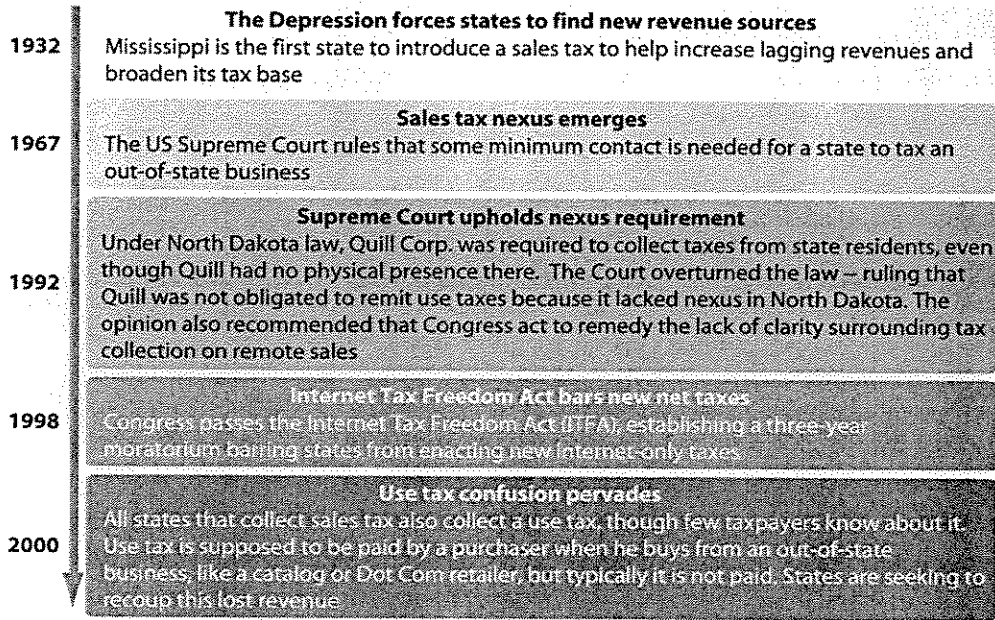
ONLINE TRADE'S GROWTH HAS CAPTURED TAX ATTENTION

Sales tax laws that date back to the 1930s are ill-equipped to preside over the borderless world of eCommerce (see Figure 1). Their shortcomings will become even more starkly apparent as online trade explodes -- with US business-to-consumer (B2C) and business-to-business (B2B) eCommerce growing to \$207 billion and \$2.7 trillion, respectively, by 2004 (see the September 2000 Forrester Report "Online Retail's Ripple Effect" and see the February 2000 Forrester Report "eMarketplaces Boost B2B Trade").

Net sales exacerbate two issues that have long plagued public tax administrators and tax counsels at retail companies: 1) uncertainty about how to tax commerce in which the buyer and seller are in different states, and 2) administering and complying with an increasingly complex and varied web of sales tax laws. But the debate over how to collect taxes on Web transactions has moved to center stage because:

- **Eroding tax bases bring a sense of urgency to the debate.** The economy has tilted toward services -- which are largely untaxed -- and only 40% of consumption is presently subject to sales taxes, according to one estimate. To compensate, states have steadily raised rates. When sales taxes were first introduced during the Great Depression, rates were below 1%; now they are estimated to average 6% nationally. Even in good economic times, states fear their surpluses will evaporate unless new revenue sources are found.
- **Physical-presence requirements limit tax collection.** The Supreme Court has ruled that a firm -- online or offline -- must have nexus, physical presence, within a state or it can't be required to collect sales taxes from customers in that state. Consumers are supposed to pay taxes on anything they purchase from a catalog over the Internet, but no one does. States have done little to collect these "use taxes" or educate constituents about them.

Figure 1 The Evolution Of Sales Tax



Source: Forrester Research, Inc.

- **eCommerce tax myths predominate.** Many believe -- incorrectly -- that the Internet Tax Freedom Act (ITFA) passed by Congress in 1998 made the Internet tax free. It did *not*. Consumers are charged taxes on Internet purchases from companies that have nexus in their state, and they are supposed to pay use taxes on the rest of their online purchases. ITFA legislation merely prevents states from adopting new Internet-specific taxes.

The Net Has Emerged As A Catalyst For Long-Languishing Tax Reform Efforts

The states have been confronted with a buzz about eCommerce and predictions that Net sales will soon dwarf catalog sales. In this environment, previously unpalatable proposals to reform the US sales tax system have been resuscitated:

- **The Streamlined Sales Tax Project (SSTP) owns the most mindshare.** States are working to create model legislation intended to simplify their current buffet of more than 7,500 tax codes (see Figure 2). Tax administrators from 27 participating and 12 observing states comprise the group and have high hopes for simplification efforts (see Figure 3).

Figure 2 The Streamlined Sales Tax Project's Agenda

Streamlined Sales Tax Project (SSTP)	Challenge	Goal
<ul style="list-style-type: none"> • Established in March 2000 • Comprises tax administrators from 39 states 	<p>There are more than 7,500 tax jurisdictions in the US. The Supreme Court has ruled that it is an undue burden for remote sellers to collect taxes, maintain records, and remit taxes to multiple jurisdictions</p>	<p>States want to gain the ability to collect use taxes from remote sellers</p>
Critical issues to be addressed		
<ul style="list-style-type: none"> • Audits • Exemption administration • Privacy policy • Rounding rules 		<ul style="list-style-type: none"> • Tax rates • Technology models • Uniform definitions • Uniform rules for bad debts
Strategy		
<ol style="list-style-type: none"> 1) To craft model legislation to be adopted by each state that would modernize sales tax systems by simplifying state tax codes and tax administration processes uniformly across the US 2) The group hopes to reduce the collection burden placed on remote sellers enough so as to convince Congress to mandate that remote sellers collect and remit use taxes to states 		

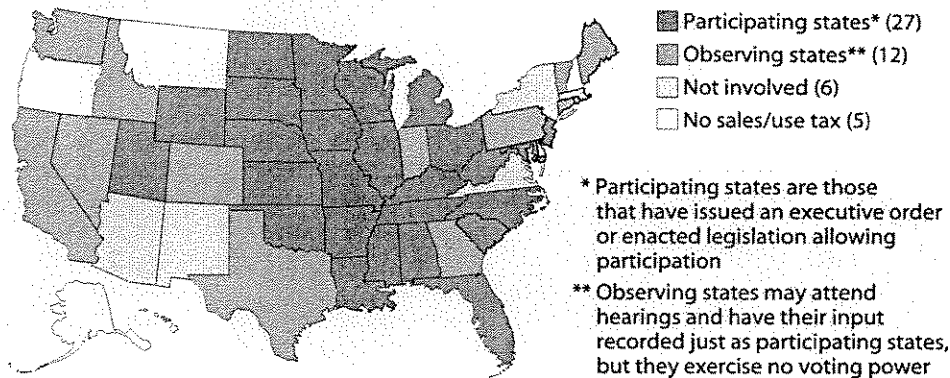
Source: Forrester Research, Inc.

- **Renegade state initiatives dot the landscape.** Individual states have already begun working on their own to expand collection of taxes from remote sellers. Earlier this year, the California legislature proposed expanding the definition of physical presence in the state for the purpose of tax collection (though Gov. Gray Davis subsequently vetoed it).
- **Many have stepped up use tax collection efforts.** A number of states have made short-term efforts to recoup lost sales tax revenue. Some, such as Maine and North Carolina, include a line on their income tax return forms prompting taxpayers to report taxable out-of-state purchases. North Carolina and Connecticut have also entered into agreements with other states to share audit information and go after negligent purchasers.
- **The ITFA extension clouds the issue.** In 2001, Congress will consider whether to extend the current moratorium mandated by ITFA on new Internet-specific taxes. Sen. John McCain (R-AZ) has favored permanently enacting the moratorium on new Internet taxes. Meanwhile, Sen. Byron Dorgan (D-ND) has thrown his energy behind legislation that would sanction states' abilities to collect use taxes if enough of them simplify their tax codes.

Figure 3 The Streamlined Sales Tax Project's Membership

3-1

Who supports the SSTP and who doesn't



3-2

What states think will happen



SSTP optimists

The time is right for reform

"There is much more cooperation in the Streamlined Sales Tax Project than in any prior attempt at reform. States know that this is a necessary and real opportunity for simplification and for ensuring revenues for the future."

A sensible and realistic approach

"I think ultimately it will succeed. The proposals are generally good and have realistic aims. It will result in a much simpler tax system. The commitment is to a simpler system, easier registration, easier filing and payment -- simpler rules in general."

Great concerns about revenue losses

"They'll have to be successful if the sales tax and associated revenue is to be preserved. There will be too big a loss in revenue and too much of a shift in business to the Dot Com world to ignore. We will succeed only together, cooperatively."

Everybody wins with simplification

"These simplifications are good for retailers, good for manufacturers. Narrowing down definitions may present some minor problems, but I can't see anyone as against simplification."



SSTP pessimists

Just too many taxing authorities

"We'll never get every one of those states to standardize, never mind the numerous local tax authorities. We'll never get the uniformity necessary to make it work."

Concerns over loss of state authority

"SSTP successful? No, no way. State legislators like to use their base as a 'gimme' tool. An overarching plan like the SSTP takes away legislative authority and a plum that legislators like to use to reward specific industries. As long as you have 50 legislatures, it can't go anywhere."

Common definitions are the major hurdle

"I think it will be very, very difficult. Common and uniform definitions will be extremely difficult to reach. How do you define what's a snack food, what's candy? Seemingly arbitrary tax laws are everywhere. It will be a very difficult process to agree on these definitions."

Political ego and inertia will thwart efforts

"The SSTP, as designed, will not be successful. There may be very small gains. No one is a proponent of the antiquated mess we are now dealing with, but there is a huge tendency to pay political lip service, doing little to affect real change."

Based on interviews with 27 state and local tax administrators

Source: Forrester Research, Inc.

ANALYSIS

Remote Sellers Will Ultimately Collect Taxes

After decades of wrangling, the one-two punch of watered-down simplification and improved tax collection technology will be enough to compel Congress to mandate that remote sellers remit use taxes -- but not before 2005.

A LACK OF VIABILITY WILL DERAIL MOST SOLUTIONS

States' sales tax laws reflect 70 years of logrolling by parochial interests. The labyrinth of issues under discussion, tangled legal precedents, and the political combustibility of any tax changes will limit the impact of most proposed reforms.

- **Federal proposals will go nowhere.** Federal legislators are loath to open the sovereignty can of worms that comes with any new law regarding sales tax collection on remote sales. They would risk angering taxpayers and the states, while receiving no federal revenue in return. For now, federal legislation will only serve as a club to spur state action.
- **Renegade states won't be able to go it alone.** Efforts by states like California to expand collection will merely scare away businesses and mire states in legal challenges from angry retailers. With more than 7,500 individual tax jurisdictions in the US, reform must combine a critical mass of them, or businesses will just relocate to jurisdictions that fit their needs. Forrester believes that any significant effort to reform sales tax must include at least 20 states.
- **Supreme Court action will be little more than a wild card.** Some believe that a state audit of an e-tailer not collecting taxes will make its way to the Supreme Court and generate a ruling on nexus and eCommerce that will resolve the debate. But judicial resolution won't come before years of appeals make their way up through the courts. Even if the Supreme Court acts, the judicial branch has shown its strong preference that Congress legislate any redefinition of nexus.

Streamlined Sales Tax Effort Controls The Debate

Despite the Streamlined Sales Tax Project's limited visibility and even more limited resources, Forrester believes that the SSTP is the only viable effort with the ability to preserve state sales taxes. The group has assumed the central place in the debate by:

- **Targeting long-problematic administration and tax code complexity.** Differences among individual states' and tax jurisdictions' product definitions have grown more complex as states have carved out exemptions to attract business. And sellers are burdened by administrative tasks like authenticating and storing tax-exemption certificates. In response, the SSTP is creating common definitions for goods and looking at automating and transferring the burden of proof for exemptions to buyers.
- **Bringing a broad coalition of players to the table.** State tax administrators lead the project, but since its beginning, the group has sought assistance from the business community (see Figure 4). The project has held public hearings to elicit comments, and it will rely on the lobbying muscle of sympathetic retail chains when it submits model legislation to state legislatures early next year.
- **Bundling policy reform with new technology solutions.** The SSTP is attacking the definitional and administrative problems that predate the Internet and fusing its proposals for resolution with recommendations for employing new Net-based tax collection software. A pilot project wherein vendors will remit use taxes to four states using new tax collection technology starts this month.

STATES WILL CLEAR HURDLES TO REACH SALES TAX RESOLUTION

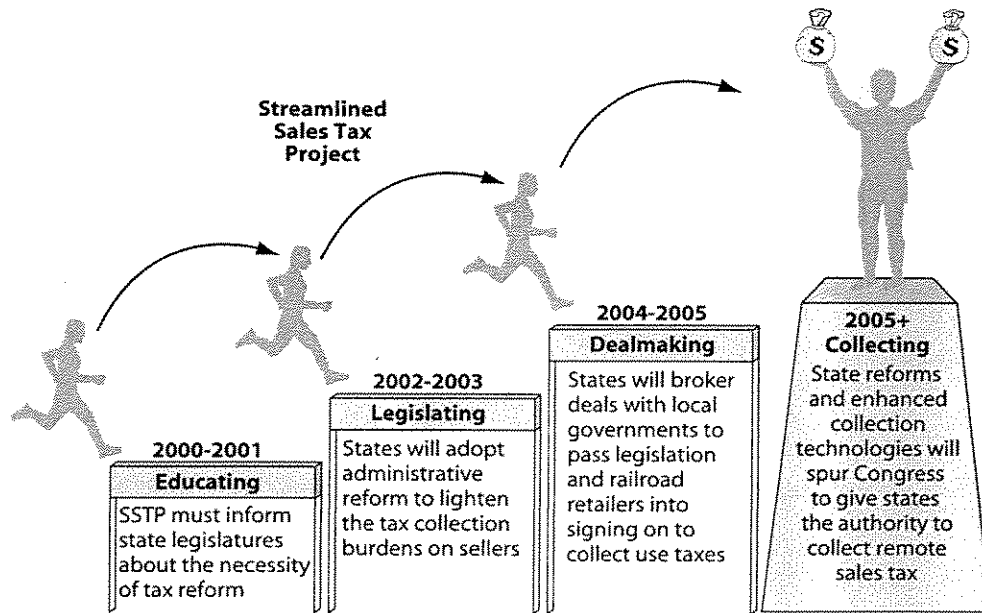
The Streamlined Sales Tax Project has momentum, wide buy-in, and timing on its side. Working with states, the group will help to compel Congress to require Internet retailers to collect use taxes on purchases -- but not before 2005. Prior to gaining the ability to collect taxes, state efforts will face a series of hurdles through four phases (see Figure 5).

- 1) **Educating (2000-2001).** Tax reform groups will scramble to draft legislation while informing legislatures about the necessity of reform.
- 2) **Legislating (2002-2004).** State legislatures will pass politically palatable laws that lighten businesses' administrative responsibilities.
- 3) **Dealmaking (2003-2005).** After initially kowtowing to retailers, states will work to coerce remote sellers to voluntarily collect use taxes.
- 4) **Collecting (2005+).** The combination of light simplification and advanced technology will compel Congress to mandate remote sales tax collection.

Figure 4 SSTP Decision-makers Have A Range Of Motivations

Who's in		What they say	What they mean
👍	State governments	Our burdensome and overly complex sales tax system is ripe for reform	The Net presents a great opportunity to get revenue from remote sales and usurp local taxing authority
	Traditional retailers	We would like for the tax system to be streamlined to reduce the burden for everyone	We're tired of these Dot Coms getting away without paying these taxes. If we have to pay, they should, too
	Technology vendors	With the cooperation of the states, the technology exists to craft a national tax system	We want to help the states simplify the tax code but not to the point where our services are not needed
Who's out		What they say	What they mean
👎	Local governments	We are amenable to tax reform to level the playing field for our Main Street retailers	We are in a tough spot -- we rely on the revenue and know reform is needed but are reluctant to lose local authority
	e-tailors	Nothing -- maybe if we're quiet this issue will just go away	We don't want to lose the competitive advantage that lax tax collection allows
	B2B Sector	What SSTP?	No really, there's a project currently underway to simplify tax codes? No one told us about it

Figure 5 SSTP Will Overcome Hurdles On The Way To Reform



Source: Forrester Research, Inc.

Phase One: Educating (2000-2001)

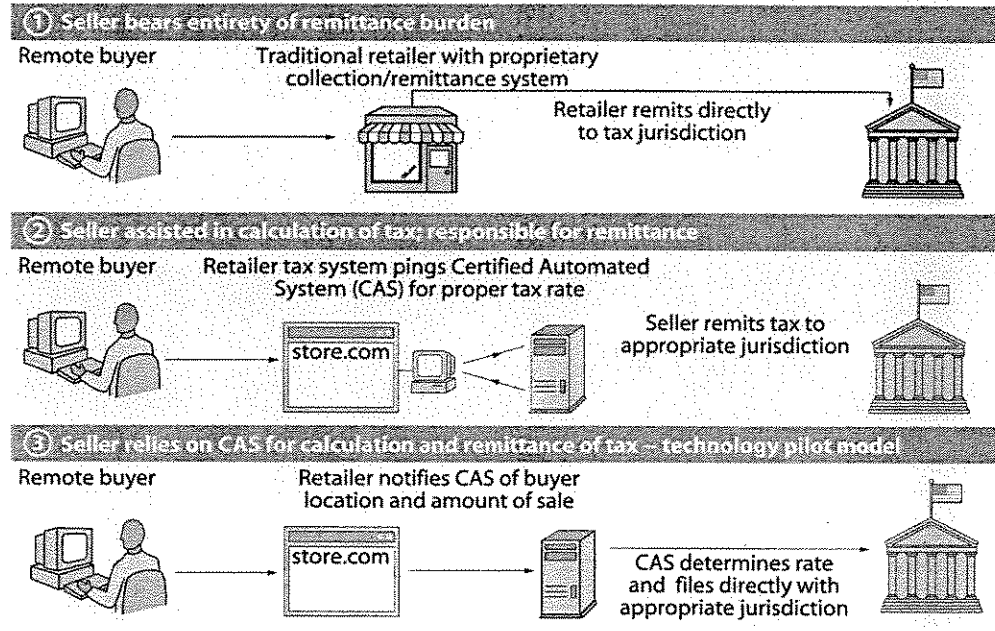
Dissemination and education efforts will consume streamlined sales tax advocates for the immediate future. Few state legislators even know that a project is underway to allow states to begin collecting use taxes from remote sellers. Streamliners had hoped to pass legislation in at least four states next year, but Forrester believes they've underestimated the work needed to educate legislatures about the need for streamlining. For the next year, tax reformers will work to assure state and federal representatives that proposed legislation does not impose new taxes on eCommerce. At the same time, they'll closely monitor the progress of the technology pilot.

- **SSTP will pass the baton to the NCSL.** The National Conference of State Legislatures (NCSL) plans first to tweak and then to endorse the coming model legislation. When legislatures convene next year, the National Governors' Association (NGA) will join the NCSL in proselytizing sales tax simplification legislation to states as a means of reducing government bureaucracy.
- **Tax technology will take a test-drive.** Working with Kansas, Michigan, North Carolina, and Wisconsin, volunteer retailers will test the ability of technology to make collecting taxes easier. Tax software vendors TAXWARE, Vertex Software, and esalestax.com will get their shot to prove that technology can solve much of the tax collection problem (see the February 7, 2000 Forrester Brief "Internet Sales Taxes Don't Need A Tea Party"). The pilot will test the certified automated service method of automating use tax collection and remittance (see Figure 6). States hope to announce their results in 2001.
- **Congress will extend ITFA with minimal additions.** States will closely watch the progress of a rider to the ITFA moratorium extension proposed by Sen. Dorgan that would grant states the ability to collect use taxes once 20 states simplify their systems uniformly. Though the ITFA moratorium will likely be extended, Dorgan's automatic trigger will likely be defeated -- because Congress would prefer to postpone discussions about expanding states' ability to collect taxes. But deliberations over the rider's fate will presage how Congress will respond to the expansion of states' tax collection responsibilities.

Phase Two: Legislating (2002-2004)

In the second phase of sales tax deliberations, streamliners' efforts will focus on building legislative momentum. Having educated legislatures about the issues at stake, the SSTP will focus on actually getting something passed. By the end of this phase, advocates will finally begin to convince skeptics that the debate can be resolved -- pointing to their political victories and successful returns from the technology pilots.

Figure 6 Tax Collection Technology Models



Source: Forrester Research, Inc.

- **States will trumpet pilot results to dispel collection burden concerns.** In the wake of the 2001 holiday season, states will announce favorable results from the pilot tax collection effort -- highlighting the ease of the system for retailers. Streamlining advocates will craft politically viable legislation that highlights states' ability to reduce burdens by standardizing administrative hassles like tax remittance frequency.
- **Five states will take the lead in passing new regulations.** Though advocates had hoped legislation would be passed earlier, they'll sign on their first five states in 2002. The first to approve will be North Carolina, Michigan, and Florida (see Figure 7). Legislatures will bundle reforms to Web-enable exemption processing and seller registration with popular eGovernment initiatives.
- **States will use momentum to bring locals aboard.** In return for a share of new revenues, locals in holdout states like Pennsylvania will soften their hard-line stances and allow their tax bases to match the states' -- one of the prerequisites for streamlined legislation. However, streamlining efforts in the three states that have tax home rule will stall -- Denver's already projected that it would lose 27% of its revenue if it cuts the number of items it taxes to sync with the state of Colorado.

Figure 7 States Will Adopt Tax Simplification Legislation At Different Times

Proving ground states (2001-2002)	Cautious optimists (2002-2004)	SSTP swing states (2004+)	Holdouts
States that are participating in the technology pilot project and depend heavily on sales tax revenue will be the first to adopt SSTP legislation	States with uniform bases will wait until the first wave of state adoption proves successful before passing legislation	States that rely less on sales tax revenue and have more complex tax codes will take longer to adopt streamlined legislation	States with no sales tax or great local control over tax bases and rates may never take the necessary steps to streamline their tax systems
<ul style="list-style-type: none"> • Florida • Kansas • Michigan • Mississippi • North Carolina • Wisconsin 	<ul style="list-style-type: none"> • Connecticut • Kentucky • Maryland • Nevada • New Jersey • Rhode Island • South Dakota • Tennessee • Washington • West Virginia 	<ul style="list-style-type: none"> • Alabama • Arizona • Arkansas • California • Georgia • Hawaii • Idaho • Illinois • Indiana • Iowa • Louisiana • Maine • Massachusetts • Minnesota • Missouri • Nebraska • New Mexico • North Dakota • Ohio • Oklahoma • Pennsylvania • South Carolina • Texas • Utah • Vermont • Wyoming 	<ul style="list-style-type: none"> • Alaska • Colorado • Delaware • Montana • New Hampshire • New York • Oregon • Virginia

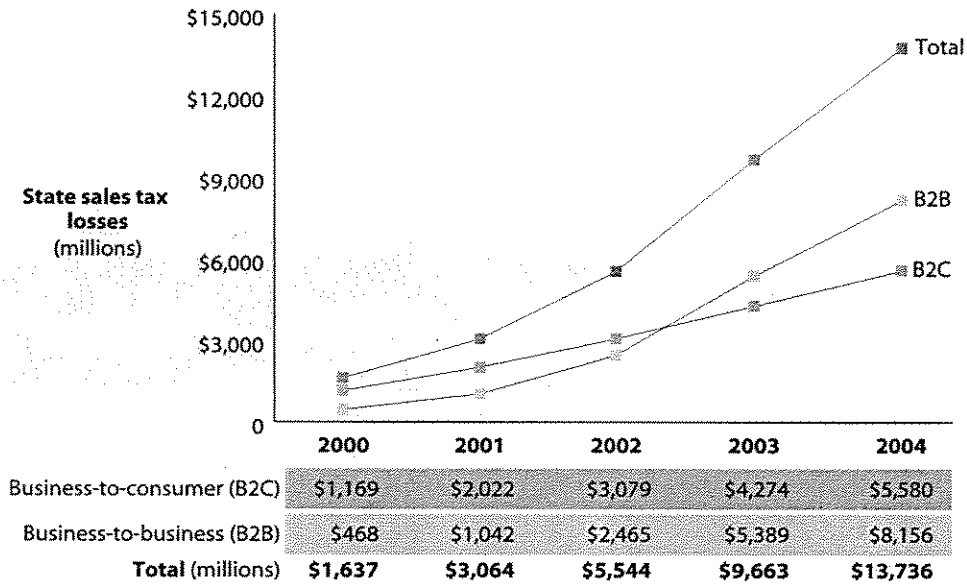
Source: Forrester Research, Inc.

- **Lessening of liability will drive voluntary retailer sign-ups.** Sellers with both online operations and a wide physical presence like JCPenney will be the first to sign on to remit taxes. They'll reduce audit liability and shift the burden of proof for tax exemption to buyers in return for collecting taxes they would have had to collect anyway. It makes sense; Forrester's research shows that consumers don't care that much about paying sales tax online anyway -- shipping charges are a far greater concern (see the February 24, 2000 Forrester Brief "States Lose Half A Billion In Taxes To Web Retail").

Phase Three: Dealmaking (2003-2005)

In this phase, streamlined system advocates will bargain in many states -- forsaking contentious definition legislation to get more acceptable administrative streamlining approved. States will also play hardball with retailers to force them to voluntarily remit sales and use taxes. By 2003, a renewed sense of urgency will pervade the Net sales tax debate. By this time, there will likely be a slowdown in the economy. Online retail will reach \$155 billion -- almost four times its total in 2000. Combined with increased business utilization of eMarketplaces, states' potential revenue loss will be \$14 billion if no measures are taken to expand their collection of use taxes (see Figure 8).

Figure 8 eCommerce Sales Tax Loss Will Grow to \$13 Billion By 2004



Source: Forrester Research, Inc.

- A second round of proposals will allow states to opt out of definitions.**
While states will pass administrative simplification legislation, many will hesitate to redefine their state's tax definitions out of fear that they'll lose the ability to attract and retain businesses in their states. Reformers will begin to give states more legislative flexibility to decide if they want to revise definitions. They'll present legislation with mandatory administrative elements and an optional, à la carte set of definitions from which states can choose in areas like food and clothing.
- Threatened lawsuits will force participation of nexus-dodging retailers.**
Early on, brick and mortars like Barnes & Noble and Wal-Mart ran an end-around against existing nexus laws by spinning off Dot Com businesses as separate entities. But now that they've realized that a brick-and-mortar presence is an asset, they're accepting in-store returns and offering cross-promotions. States that have passed streamlined legislation will use the threat of legal action to coerce retailers like Walmart.com to begin to use the SSTP system to remit taxes.
- States will audit B2B eMarketplaces.** Though states have focused their attention on the retail sector, by 2003 they'll realize that the larger opportunity is lost revenue from businesses failing to remit use taxes. States will run use tax

education campaigns aimed at businesses and audit office-supply eMarketplaces like PurchasingCenter.com to nab small and medium-sized businesses that haven't paid use taxes on nonproduction materials they've bought online.

- **Efforts to bring Dot Coms on board will sputter.** Current policies limit the credits states can offer retailers in return for collecting taxes. Because states are leery about giving special treatment to remote sellers, they won't be able to grant significant incentives to Net retailers to collect use taxes. Pure-play Dot Coms will hold out on voluntarily collecting while struggling to differentiate themselves in an environment requiring profit-oriented business models.

Phase Four: Collecting (2005+)

By 2005, the tax issue will begin to lose its political combustibility. Most surviving Dot Com retailers will necessarily expand their presence to meet customers' needs with warehouses, strategically placed stores, and local delivery partnerships (see the April 2000 Forrester Report "The Demise Of Dot Com Retailers"). As a result, Dot Coms will be collecting taxes they had previously avoided -- tax reform or not. States will use a few highly publicized audits of businesses negligent in remitting use taxes to scare the rest into complying with reporting. Legislative action, brought by the new Congress in January 2005, will be packaged as an eGovernment initiative -- rewarding with revenue those states that simplify businesses' remote sales tax burdens.

- **States will upgrade their internal systems.** As retailers retool collection systems and plug in to tax collection technology solutions, states will focus efforts on their own tax collection back ends. To reduce retailers' burdens, they'll encourage online reporting and eliminate monthly forms in favor of automated transfers. Retailers will be able to file at their convenience -- ranging from daily to annually.
- **Businesses will focus lobbying efforts on burden reduction.** Realizing that Congressional action is inevitable, businesses will lobby Congress to mandate that states must simplify to the point of one tax rate per state in order to collect remote taxes. Lobbyists will advocate the creation of a sales tax structure like that of the International Fuel Tax Association (IFTA). Within IFTA, truckers submit fuel tax returns to their home states, relying on them to remit to any other owed states.
- **Congressional action will occur as an eGovernment play.** After more than two-thirds of states have done the dirty work of streamlining their systems, the issue will have cooled off enough for Congress to step in. Congress will craft a bill as an eGovernment incentive package for states -- thus ducking anti-tax proponents. In return for upgrading their collection systems and simplifying requirements placed on vendors, states will receive taxes from remote sales.



ACTION



Traditional retailers should change their tune.

While traditional retailers have helped to forward the efforts of the SSTP, their goal has been more to burden online retailers with onerous tax collection responsibilities than achieving simplification. By coming to the table with this narrow motivation, brick-and-mortar chains risk missing an unprecedented chance to work with governments to reduce tax collection burdens for all sellers. Retailers should invite Dot Coms to the table and both should work with states to create a truly simpler system for collecting taxes. Simpler tax structures mean increased profitability for all retailers.



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WHAT IT MEANS

15

The implications of simplified taxes and remote seller collection of use taxes are significant:

- ❗ **SSTP will provide a model for future state deliberations.**
The ageographical nature of the Internet will spark further showdowns between fragmented state-level policies and the need for uniform standards. States will turn to the SSTP model as they scramble for control over issues like state franchise laws, insurance, and financial privacy policies. By collaborating closely in crafting new policies, states retain their sovereignty while eliminating the newly glaring inconsistencies in individual states' policies.
- ❗ **Streamlined project will pave the way for a VAT discussion.**
Even as legislators sort out sales tax in the US, they'll be preparing to take their discussions international. Global eCommerce will continue to grow -- forcing countries to discuss how to administer taxes on eCommerce purchases that travel across borders. Most of the rest of the world uses a value-added tax (VAT), which at present would be political impossible in the US. But after legislators spend five years overhauling tax systems, the VAT might be easier to imagine as a way of easing US-international trade discrepancies.
- ❗ **States will use Net cash registers to ease retailers' pain.**
Once states start collecting taxes from remote sellers, they'll turn their focus to small and medium-sized retailers within their borders. States will offer these sellers assistance to buy and implement Web cash registers from NCR and IBM. Offering registers that automate tax remittance will help states get their hands on taxes more quickly and easily, and it will free retailers from their current audit risks.
- ❗ **The tax system will create a real-time economic indicator.**
When remote sellers are collecting taxes on all purchases and traditional retailers are using Net cash registers to ring up sales, the result will be a wellspring of retail data. With immediate information about buyers' spending habits, clothing makers will be able to see which styles are selling where and adjust distribution accordingly. More significant, governments will be able to release daily retail indexes charting consumer attitudes and the economy's health.

16



Improved collection will force states to cut rates.

As states have historically exempted more purchases from taxes, they have responded by raising tax rates. Taxing remote sales will -- at least temporarily -- reverse this trend, allowing states to expand some of their shrinking base. It won't be long before consumers rally for their tax rates to be cut. States will respond in kind -- once they're gaining new revenue and spending less pursuing tax dodgers, they'll be able to reduce sales tax rates without having to downsize police departments.



Retailers will race to recast themselves as service providers.

Product sellers are increasingly turning toward bundled services to differentiate their offerings. Most states don't tax services. The trend toward bundled services will accelerate as sellers continue to look for loopholes to avoid charging taxes to consumers. On-demand deliverers like Peapod.com will classify their business as a grocery-replenishing service. States will have to make another effort to streamline definitions -- this time, between goods and services -- or risk missing out on a new generation of tax revenue.



eMarketplaces will plug in use tax services as a value-add.

As states expand efforts to collect use taxes from businesses, smart eMarketplaces will plug in tax collection providers like TAXWARE to offer buyers the service of automatically collecting and remitting use taxes on goods. Business buyers will welcome the service, anxious to avoid audits on their buying. Governments will sanction the process and offer incentives to eMarketplaces that take the initiative in assuming this responsibility.

RELATED MATERIAL

For this report, Forrester spoke with 26 state and local tax administrators, as well as with accounting firms, traditional retailers, technology vendors, government groups, lawyers, and academics.

Individuals Interviewed For This Report

William F. Fox, Professor, University of Tennessee
www.utk.edu

George Isaacson, General Counsel, Direct Marketing Association
www.the-dma.org

Rich McKeown, Chief of Staff, Utah Governor's Office
www.governor.state.ut.us

Valerie Price, Writer, Advisory Commission on Electronic Commerce
www.ecommercecommission.org

Stan Sokul, Member, Advisory Commission on Electronic Commerce
www.ecommercecommission.org

Companies And Organizations Interviewed For This Report

CommerceNet
www.commerce.net

Committee On State Taxation (COST)
www.statetax.org

Deloitte Touche Tohmatsu
www.deloitte.com

Ernst & Young
www.ey.com

esalestax.com
www.esalestax.com

Federated Department Stores
www.federated-fds.com

Federation of Tax Administrators
www.taxadmin.org

International Fuel Tax Administration (IFTA)
www.iftach.org

Hewlett-Packard
www.hp.com

National Conference of State Legislatures
www.ncsl.org

National Governors' Association
www.nga.org

National League of Cities
www.nlc.org

National Retail Federation
www.nrf.com

Nationtax Online
www.nationtax.com

NCR
www.ncr.com

PricewaterhouseCoopers
www.pwcglobal.com

Streamlined Sales Tax Project
www.streamlinedsalestax.org

TaxNet Systems
www.taxnetsystems.com

TAXWARE International
www.taxware.com

The Council of State Governments
www.statesnews.org

The Heritage Foundation
www.heritage.org

Toys "R" Us
www.tru.com

US General Accounting Office
www.gao.gov

Vertex Software
www.vertex.com

Related Research

April 2000 Forrester Report "The Demise Of Dot Com Retailers"

February 24, 2000 Forrester Brief "States Lose Half A Billion In Taxes To Web Retail"

February 7, 2000 Forrester Brief "Internet Sales Taxes Don't Need A Tea Party"

February 2000 Forrester Report "eMarketplaces Boost B2B Trade"

GRAPEVINE

Dad, I can't sleep. Tell me about your tax meeting.

One of our interviewees talked about how he had to take his son to a National Tax Association meeting last summer. The meeting passed uneventfully, and Dad had forgotten about the event until his son recently asked him some further questions about it. He was flattered that his son was taking an interest in his work -- until he found out his son was writing an essay on "The Most Boring Thing I've Ever Done."

.....

We take it back.

Robert Molloy, VP at Staples, drew some chuckles at the Streamlined Sales Tax Project's October 26, 2000, public meeting during his testimony to the Project's heads. Speaking about the 1992 Quill v. North Dakota Supreme Court case, Molloy mentioned that since the case Staples has acquired Quill, and "we wish that we could simply assert the litigant was wrong" -- meaning that they could reverse the Court's ruling that remote sellers do not have to collect use tax. Molloy's statement illustrates just how much traditional retailers like Staples want to expand tax burdens of remote sellers.

.....

Stupid tax-exemption tricks.

In the course of our research, we came across a startling array of strange and confusing tax codes implemented by states and localities over time. A few of our favorites: In Wisconsin, juices are tax exempt unless the label uses the words cocktail, drink, punch, ade, or nectar. In Pennsylvania, doughnuts are tax exempt unless they are sold at a carnival. In Minnesota, boots are tax exempt, unless they go above the knee. There are a lot more where these came from -- showing just how tough it's going to be for states to streamline this tangled web of definitions.

.....

Are tax jokes funny? It depends.

Apologizing beforehand, Lee Walthall, CEO of Nationtax Online, shared a well-traveled tax joke as we were wrapping up our conversation about his company's work at automating tax filings for businesses. "In a certain jurisdiction, adult diapers are tax exempt, while diapers for babies are taxed. Looking at this jurisdiction you might ask, 'are diapers taxable?' . . . Depends."

NOVEMBER 2000

Making Net Sales Tax Pay

By Jeremy Sharrard

With John C. McCarthy

Michael J. Tavilla

QUICK VIEW

eCommerce growth exposes deficiencies in sales tax laws. State reforms, Web-based collection technologies, and the changing complexion of online retail will ultimately force retailers to collect taxes on all remote sales.

THE LANDSCAPE

- The Net brings focus to the sales tax debate.
- Efforts to reform sales taxes have emerged on a number of fronts.

ANALYSIS

- The Streamlined Sales Tax Project is at the center of sales tax reform efforts.
- States will gain the ability to collect taxes from remote sellers.

ACTION

- Dot Coms should get their heads in the tax game.

WHAT IT MEANS

- Real-time tax collection will create economic indicators.

ACTION



Traditional retailers should change their tune.

While traditional retailers have helped to forward the efforts of the SSTP, their goal has been more to burden online retailers with onerous tax collection responsibilities than achieving simplification. By coming to the table with this narrow motivation, brick-and-mortar chains risk missing an unprecedented chance to work with governments to reduce tax collection burdens for all sellers. Retailers should invite Dot Coms to the table and both should work with states to create a truly simpler system for collecting taxes. Simpler tax structures mean increased profitability for all retailers.



Dot Coms should pull their heads out of the sand.

Online retailers have been conspicuously absent from sales tax reform deliberations. That tactic may have worked at first, but now that states are organizing to expand collection, Dot Coms should work with -- rather than ignore -- tax reformers. If they remain on the sidelines while traditional retailers help shape tax policies, Dot Coms will find themselves crippled once they are legally required to collect taxes.



Accounting firms should buy tax collecting technology vendors.

Large systems integrators and accounting firms like EDS and Ernst & Young should snap up tax collection technology vendors like esalestax.com or TAXWARE before their price tags go up. Getting involved in tax collection automation will make up for the revenues their tax practices will miss out on once states ease compliance burdens on retailers -- reducing sellers' need for accountants.



Democrats should make the tax issue their own.

Democrats have neither embraced nor distanced themselves from the Internet tax debate. Republicans are divided on the issue -- caught between states' rights and anti-tax leanings. Democrats should endorse the streamlining efforts and push Congress to pass enabling legislation. Though they'll initially face resistance from anti-tax and pro-technology critics, they'll win out if they cast their proposals as eGovernment reform. Plus, they'll garner valuable political capital from appreciative governors -- and fluster Republicans by highlighting an issue that divides them.

**UNIFORM SALES AND USE TAX
ADMINISTRATION ACT**

DRAFT 11/28/00

SECTION 1 TITLE

Section 1 through Section 11 shall be known as and referred to as the "Uniform Sales and Use Tax Administration Act".

SECTION 2 DEFINITIONS

As used in this act:

- a. "Agreement" means the Streamlined Sales and Use Tax Agreement.
- b. "Certified Automated System" means software certified jointly by the states that are signatories to the Agreement to calculate the tax imposed by each jurisdiction on a transaction, determine the amount of tax to remit to the appropriate state, and maintain a record of the transaction.
- c. "Certified Service Provider" means an agent certified jointly by the states that are signatories to the Agreement to perform all of the seller's sales tax functions.
- d. "Person" means an individual, trust, estate, fiduciary, partnership, limited liability company, limited liability partnership, corporation, or any other legal entity. "Person" does not include a State or a subdivision of a State.
- e. "Seller" means any person making sales of personal property or services.
- f. "State" means any state of the United States and the District of Columbia.

SECTION 3 LEGISLATIVE FINDING (OPTIONAL)

The (LEGISLATIVE BODY) finds that this state should enter into an agreement with one or more states to simplify and modernize sales and use tax administration in order to substantially reduce the burden of tax compliance for all sellers and for all types of commerce.

SECTION 4 AUTHORITY TO ENTER AGREEMENT

The (STATE TAXING AUTHORITY) is authorized and directed to enter into the Streamlined Sales and Use Tax Agreement with one or more states to simplify and modernize sales and use tax administration in order to substantially reduce the burden of tax compliance for all sellers and for all types of commerce. In furtherance of the Agreement, the (STATE TAXING AUTHORITY) is authorized to act jointly with other states that are members of the Agreement to establish standards for certification of a certified service provider and certified automated system and establish performance standards for multistate sellers.

The (STATE TAXING AUTHORITY) is further authorized to take other actions reasonably required to implement the provisions set forth in this Act or to otherwise substantially reduce the administrative burdens associated with sales and use tax compliance. Other actions authorized by this section include, but are not limited to, the adoption of rules and regulations and the joint procurement, with other member states, of goods and services in furtherance of the cooperative agreement.

The (STATE TAXING AUTHORITY) or the (AUTHORITY'S) designee is authorized to represent this state before the other states that are signatories to the Agreement.

SECTION 5 AGREEMENT REQUIREMENTS

The (STATE TAXING AUTHORITY) shall not enter into the Streamlined Sales and Use Tax Agreement unless the agreement requires each state to abide by the following requirements:

- a. Uniform State Rate. The Agreement must set restrictions to achieve more uniform state rates through the following:
 1. Limiting the number of state rates.
 2. Eliminating maximums on the amount of state tax that is due on a transaction.
 3. Eliminating thresholds on the application of state tax.
- b. Uniform Standards. The Agreement must establish uniform standards for the following:
 1. The sourcing of transactions to taxing jurisdictions.

2. The administration of exempt sales.
 3. The allowances a seller can take for bad debts.
 4. Sales and use tax returns and remittances.
- c. Uniform Definitions. The Agreement must require states to develop and adopt uniform definitions of sales and use tax terms. The definitions must enable a state to preserve its ability to make policy choices not inconsistent with the uniform definitions.
- d. Central Registration. The Agreement must provide a central, electronic registration system that allows a seller to register to collect and remit sales and use taxes for all signatory states.
- e. No Nexus Attribution. The Agreement must provide that registration with the central registration system and the collection of sales and use taxes in the signatory states will not be used as a factor in determining whether the seller has nexus with a state for any tax.
- f. Local Sales and Use Taxes. The Agreement must provide for reduction of the burdens of complying with local sales and use taxes through the following:
1. Restricting and eliminating variances between the state and local tax bases.
 2. Requiring states to administer any sales and use taxes levied by local jurisdictions within the state so that sellers collecting and remitting these taxes will not have to register or file returns with, remit funds to, or be subject to independent audits from local taxing jurisdictions.
 3. Restricting the frequency of changes in the local sales and use tax rates and setting effective dates for the application of local jurisdictional boundary changes to local sales and use taxes.
 4. Providing notice of changes in local sales and use tax rates and of changes in the boundaries of local taxing jurisdictions.
- g. Monetary Allowances. The Agreement must outline any monetary allowances that are to be provided by the states to sellers or certified service providers.

- h. State Compliance. The Agreement must require each state to certify compliance with the terms of the Agreement prior to joining and to maintain compliance, under the laws of the member state, with all provisions of the Agreement while a member.
- i. Consumer Privacy. The Agreement must require each state to adopt a uniform policy for certified service providers that protects the privacy of consumers and maintains the confidentiality of tax information.

SECTION 6 CERTIFICATE OF COMPLIANCE

Before the (STATE TAXING AUTHORITY) joins the Streamlined Sales and Use Tax Agreement, the (STATE TAXING AUTHORITY) must prepare a Certificate of Compliance. This certificate must list the requirements in Section 5 of this act and any other requirements of the Agreement and establish, by reference to the appropriate statute, rule, regulation, or other authority, how the state meets the requirements. If the requirements of the agreement change while the state is a member of the agreement, the (STATE TAXING AUTHORITY) must amend the certificate to reflect how the state meets the changed requirements. The (STATE TAXING AUTHORITY) must make the Certificate of Compliance available to the public.

SECTION 7 SELLER AND THIRD PARTY LIABILITY

a. A Certified Service Provider is the agent of a seller, with whom the Certified Service Provider has contracted, for the collection and remittance of sales and use taxes. As the seller's agent, the Certified Service Provider is liable for sales and use tax due each member state on all sales transactions it processes for the seller except as set out in this section.

A seller that contracts with a Certified Service Provider is not liable to the state for sales or use tax due on transactions processed by the Certified Service Provider unless the seller misrepresented the type of items it sells or committed fraud. In the absence of misrepresentation or fraud, a seller that contracts with a Certified Service Provider is not subject to audit on the transactions processed by the Certified Service Provider. A seller is subject to audit for transactions not processed by the Certified Service Provider. The member states acting jointly may perform a system check of the seller and review the seller's procedures to determine if the Certified Service

Provider's system is functioning properly and the extent to which the seller's transactions are being processed by the Certified Service Provider.

b. A person that provides a Certified Automated System is responsible for the proper functioning of that system and is liable to the state for underpayments of tax attributable to errors in the functioning of the Certified Automated System. A seller that uses a Certified Automated System remains responsible and is liable to the state for reporting and remitting tax.

c. A seller that has a proprietary system for determining the amount of tax due on transactions and has signed an agreement establishing a performance standard for that system is liable for the failure of the system to meet the performance standard.

SECTION 8 COOPERATING SOVEREIGNS

The Agreement authorized by this Act is an accord among individual cooperating sovereigns in furtherance of their governmental functions. The Agreement provides a mechanism among the member states to establish and maintain a cooperative, simplified system for the application and administration of sales and use taxes under the duly adopted law of each member state.

SECTION 9 RELATIONSHIP TO STATE LAW

No provision of the Agreement authorized by this Act in whole or part invalidates or amends any provision of the law of this state. Adoption of the Agreement by this state does not amend or modify any law of this State. Implementation of any condition of the Agreement in this state, whether adopted before, at, or after membership of this state in the Agreement, must be by the action of this state.

SECTION 10 LIMITED BINDING AND BENEFICIAL EFFECT

The Agreement authorized by this Act binds and inures only to the benefit of this state and the other member states. No person is an intended beneficiary of the Agreement.

SECTION 11 EFFECT OF AGREEMENT WITH RESPECT TO PRIVATE REMEDIES

Any benefit to a person is established by the law of this state and the other member states and not by the terms of the Agreement. No law of this state, or the application thereof, may be declared invalid as to any person or circumstance on the ground that the provision or application is inconsistent with the Agreement. No person shall have any cause of action or defense under the Agreement or by virtue of this state's approval of the Agreement. No person may challenge, in any action brought under any provision of law, any action or inaction by any department, agency, or other instrumentality of this state, or any political subdivision of this state on the ground that the action or inaction is inconsistent with the Agreement.

SECTIONS 12 THROUGH ____

INDIVIDUAL STATE AMENDMENTS

These sections are reserved for each individual state to make statutory amendments necessary to bring it into compliance with the Streamlined Sales and Use Tax Agreement. Some examples would be amending the state's current sourcing rule to comply with the new uniform rule, making the effective dates of local rate changes to the first day of a calendar quarter and providing for a sixty (60) day notice, or enacting exemptions necessary to preserve, to the extent consistent with the uniform definitions, current non-taxability of various goods and services.

SECTION ____ EFFECTIVE DATE (OPTIONAL)

Sections 1 through 11 of this act are effective upon ratification (or whatever phrase is used in your state to indicate that the act is effective immediately) or specific date.

Sections 12 through ____ of this act becomes effective on the date this state becomes a member of the Streamlined Sales and Use Tax Agreement.

**STREAMLINED SALES AND USE TAX
AGREEMENT**

**NOVEMBER 30, 2000
DRAFT**

TABLE OF CONTENTS

Article I Purpose and Principle

100	Title	4
102	Fundamental Purpose	4

Article II Definitions

200	Agent	5
202	Agreement	5
204	Certified Automated System (CAS)	5
206	Certified Service Provider (CSP)	5
208	Model 2 Seller	5
210	Model 2 Seller	5
212	Model 3 Seller	5
214	Person	6
216	Purchaser	6
218	Registered Under This Agreement	6
220	Seller	6
222	State	6

Article III Requirements Each State Must Accept to Participate

300	Compliance	7
302	State Administration	7
304	State And Local Tax Bases	7
306	Seller Registration	7
308	State and Local Tax Levies	8
310	Uniform Sourcing Rules	10
312	Uniform Definitions	11
314	Administration of Exemptions	16
316	Uniform Tax Returns	17
318	Uniform Rules For Deductions of Bad Debts	18
320	Uniform Rules For Remittances of Funds	19
322	Confidentiality And Privacy Protections	19

Article IV Seller Registration

400	Seller Participation	22
402	Method Of Remittance	23

404	Registration By An Agent	23
Article V		
Provider And System Certification		
500	Certification Of Service Providers And Automated Systems	24
Article VI		
Monetary Allowances for Participation		
600	Monetary Allowances For CSPs And Sellers	25
602	Monetary Allowance Under Model 1	25
604	Monetary Allowance Under Models 2 And 3	25
Article VII		
State Entry and Withdrawal		
700	Entry Into Agreement	26
702	Certification Of Compliance	26
704	Initial Adopting States	26
706	Conditions For Membership	26
708	Agreement Administration	26
710	Withdrawal Of Membership	27
712	Revocation Of Membership	27
714	Effective Date	27
Article VIII		
Amendments and Interpretations		
800	Amendments To Agreement	28
802	Interpretations Of Agreement	28
Article IX		
Relationship Of Agreement To Member States And Persons		
900	Cooperating Sovereigns	29
902	Relationship To State Law	29
904	Limited Binding And Beneficial Effect	29
906	Effect of Agreement With Respect To Private Remedies	29
908	Final Determinations	29
Appendix A		
	Letter of Intent	30

1 **STREAMLINED SALES AND USE TAX AGREEMENT**
2
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4 **ARTICLE I**
5 **PURPOSE AND PRINCIPLE**
6

7 **100 TITLE**
8

9 This multistate Agreement shall be referred to, cited and known as the
10 Streamlined Sales and Use Tax Agreement.
11

12 **102 FUNDAMENTAL PURPOSE**
13

14 It is the purpose of this Agreement to simplify and modernize sales and use tax
15 administration in the member states in order to substantially reduce the burden of
16 tax compliance. The Agreement focuses on improving sales and use tax
17 administration systems for all sellers and for all types of commerce through all of
18 the following:
19

- 20 a. State level administration of sales and use tax collections.
- 21
- 22 b. Uniformity in the state and local tax bases.
- 23
- 24 c. Central, electronic registration system for all member states.
- 25
- 26 d. Simplification of state and local tax rates.
- 27
- 28 e. Uniform sourcing rules for all taxable transactions.
- 29
- 30 f. Uniform definitions within tax bases.
- 31
- 32 g. Simplified administration of exemptions.
- 33
- 34 h. Simplified tax returns.
- 35
- 36 i. Uniform rules for deductions of bad debts.
- 37
- 38 j. Simplification of tax remittances.
- 39
- 40 k. Protection of consumer privacy.
- 41

42
43 **ARTICLE II**
44 **DEFINITIONS**

45
46 The following definitions apply in this Agreement:

47
48 **200 AGENT**

49
50 A person appointed by a seller to represent the seller before the member states.
51

52 **202 AGREEMENT**

53
54 The Streamlined Sales and Use Tax Agreement and as subsequently amended.
55

56 **204 CERTIFIED AUTOMATED SYSTEM (CAS)**

57
58 Software certified under the Agreement to calculate the tax imposed by each
59 jurisdiction on a transaction, determine the amount of tax to remit to the
60 appropriate state, and maintain a record of the transaction.
61

62 **206 CERTIFIED SERVICE PROVIDER (CSP)**

63
64 An agent certified under the Agreement to perform all the seller's sales and use
65 tax functions.
66

67 **208 MODEL 1 SELLER**

68
69 A seller that has selected a CSP as its agent to perform all the seller's sales and
70 use tax functions.
71

72 **210 MODEL 2 SELLER**

73
74 A seller that has selected a CAS to perform part of its sales and use tax
75 functions, but retains responsibility for remitting the tax.
76

77 **212 MODEL 3 SELLER**

78
79 A seller that has sales in at least five member states, has total annual sales
80 revenue of at least One Billion Dollars (\$1,000,000,000), has a proprietary
81 system that calculates the amount of tax due each jurisdiction, and has entered
82 into a performance agreement with the member states that establishes a tax
83 performance standard for the seller.
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88 **214 PERSON**

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90 An individual, trust, estate, fiduciary, partnership, limited liability company, limited
91 liability partnership, corporation, or any other legal entity. "Person" does not
92 include a State or subdivision of a State.

93

94 **216 PURCHASER**

95

96 A person to whom a sale of personal property is made or to whom a service is
97 furnished.

98

99 **218 REGISTERED UNDER THIS AGREEMENT**

100

101 Registration by a seller with the member states under the central registration
102 system provided in Article IV of this Agreement.

103

104 **220 SELLER**

105

106 A person making sales of personal property or services to persons within a
107 member state.

108

109 **222 STATE**

110

111 Any state of the United States and the District of Columbia.

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**ARTICLE III
REQUIREMENTS EACH STATE MUST
ACCEPT TO PARTICIPATE**

117 **300 COMPLIANCE**

118
119 As a requisite to entering into and remaining a member of the Agreement, each
120 State must comply with the provisions of this Agreement in accordance with the
121 provisions of Article VII of this Agreement.
122

123 **302 STATE ADMINISTRATION**

124
125 Each State must provide state level administration of sales and use taxes.
126 Sellers are only required to register with, file returns with, and remit funds to the
127 state taxing authority. The State must collect any local taxes and distribute them
128 to the appropriate taxing jurisdictions. Member states must conduct all audits of
129 the sellers registered under this Agreement and local jurisdictions shall not
130 conduct independent sales or use tax audits.
131

132 **304 STATE AND LOCAL TAX BASES**

133
134 Through December 31, 2005, if a member state has local jurisdictions that levy a
135 sales or use tax, all local jurisdictions in the State must have a common tax base.
136 After December 31, 2005 the tax base for local jurisdictions must be identical to
137 the state tax base, unless otherwise prohibited by federal law.
138

139 **306 SELLER REGISTRATION**

140
141 Each State must participate in an online sales and use tax registration system in
142 cooperation with the other member states. Under this system:
143

- 144 a. A seller registering under the Agreement is registered in each of
145 the member states.
146 b. The member states agree not to require the payment of any
147 registration fees or other charges for a seller to register in a
148 State in which the seller has no physical presence.
149 c. A written signature from the seller is not required.
150 d. An agent may register a seller.
151 e. A seller may cancel its registration under the system at any
152 time. Cancellation does not relieve the seller of its liability from
153 remitting to the proper states any taxes collected.
154
155
156
157

158 **308 STATE AND LOCAL TAX LEVIES**

159
160 a. To reduce the complexity and administrative burden of collecting sales and
161 use taxes, all member states must comply with the following:

- 162
163 1. Lessen the difficulties faced by sellers when there is a change in a
164 state sales or use tax rate or base by making every effort to do all
165 of the following:
- 166 a. Provide sellers with as much advance notice as
167 practicable of a rate change.
 - 168 b. Limit the effective date of a rate change to the first day
169 of a calendar quarter.
 - 170 c. Notify sellers of legislative changes in the tax base and
171 amendments to sales and use tax rules and regulations.
- 172 2. Not place caps or thresholds on the application of state sales or
173 use tax rates or exemptions that are based on the value of the
174 transaction or item.
- 175 3. Not have multiple state tax rates on items of personal property or
176 services after December 31, 2005. A State may continue to have a
177 generally applicable state tax rate and additional state rates until
178 that date.
- 179 4. Provide that the tax rate equals the combination of the state and
180 local sales tax rates. In computing the tax to be collected as the
181 result of any transaction, the tax amount must be carried to the third
182 decimal place. Amounts of tax less than one-half of one cent shall
183 be disregarded and amounts of tax of one-half cent or more shall
184 be considered an additional cent. Sellers may elect to compute the
185 tax due on transactions on an item or invoice basis. The election
186 must be applied consistently for all transactions.

187
188 b. Member states that provide local jurisdictions with the option of levying a
189 sales or use tax must:

- 190
191 1. Not have more than one sales tax rate or more than one use tax
192 rate per local taxing jurisdiction. If the local jurisdiction levies both a
193 sales tax and a use tax, the rates must be identical.
- 194 2. Not place caps or thresholds on the application of local sales or use
195 tax rates or exemptions that are based on the value of the
196 transaction or item.
- 197 3. Provide that local rate changes will be effective only on the first day
198 of a calendar quarter after a minimum of sixty (60) days notice to
199 sellers.
- 200 4. Apply local sales tax rate changes to purchases from printed
201 catalogs wherein the purchaser computed the tax based upon local
202 tax rates published in the catalog only on the first day of a calendar
203 quarter after a minimum of 120 days notice to sellers.

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5. For sales and use tax purposes only, apply local jurisdiction boundary changes only on the first day of a calendar quarter after a minimum of sixty (60) days notice to sellers.
 6. Provide and maintain a database that describes boundary changes for all taxing jurisdictions. This database must include a description of the change and the effective date of the change for sales and use tax purposes.
 7. Provide and maintain a database of all sales and use tax rates for all of the jurisdictions levying taxes within the State. For the identification of states, counties, cities, and parishes, codes corresponding to the rates must be provided according to Federal Information Processing Standards (FIPS) as developed by the National Institute of Standards and Technology. For the identification of all other jurisdictions, codes corresponding to the rates must be in the format determined jointly by the member states.
 8. Provide and maintain a database that assigns each nine (9) digit zip code within the State to the proper tax rates and jurisdictions. The State must apply the lowest tax rate imposed in the zip code area if the area includes more than one taxing jurisdiction in any level of taxing jurisdictions. If a nine (9) digit zip code designation is not available, the State must apply the lowest tax rate in the five (5) digit zip code area. If a seller is unable to determine the nine (9) digit zip code designation of a purchaser, the seller may apply the rate for the five (5) digit zip code area.
 9. Participate with other member states in the development of an address-based system for assigning taxing jurisdictions. The system must meet the requirements developed pursuant to the federal Mobile Telecommunications Sourcing Act. At a future date, member states acting jointly may require sellers to use an address-based system provided by a member state. If any State develops an address-based assignment system pursuant to the Mobile Telecommunications Sourcing Act, a seller may use that system in place of the system provided for in paragraph 8 of this section.
 10. Hold sellers harmless for charging and collecting the incorrect amount of sales or use tax resulting from the seller relying on erroneous data provided by a State on tax rates, boundaries, or taxing jurisdiction assignments. This hold harmless provision shall also apply to a seller employing an address-based system for assigning taxing jurisdictions pursuant to the federal Mobile Telecommunications Sourcing Act.
- c. The electronic databases, provided for in paragraphs (b)(6), (b)(7), (b)(8), and (b)(9) of this section, must be in a downloadable format approved by the member states acting jointly.

249 d. The provisions of paragraphs (b)(8) and (b)(9) do not apply when the
250 purchased product is received at the business location of the seller.

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252 e. The databases provided by (b)(6), (b)(7), and (b)(8) are not a requirement of
253 a State prior to entering into the Agreement. The effective dates will be
254 determined by the member states acting jointly.

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256 f. If a member state allows for temporary exemption periods, commonly referred
257 to as sales tax holidays, the State must not apply an exemption after December
258 31, 2003 unless the item exempted has been defined under the provisions of
259 Section 312. Further, if the State provides local jurisdictions with the option of
260 levying a sales or use tax, the State must provide notice of the exemption period
261 at least sixty (60) days prior to the first day of the calendar quarter in which the
262 exemption period will begin and apply the exemptions to both state and local tax
263 bases.

264 265 **310 UNIFORM SOURCING RULES**

266
267 The member states agree to require sellers to source the sale of a product in
268 accordance with the following provisions. These provisions apply regardless of
269 the characterization of a product as tangible personal property, a digital good, or
270 services (excluding for the present telecommunications). These provisions do
271 not apply to the obligation of a purchaser to pay tax on use or consumption of
272 the product purchased.

- 273
274 a. When the product is received by the purchaser at a business location
275 of the seller, the sale is sourced to that business location.
- 276 b. When the product is not received by the purchaser at a business
277 location of the seller, the sale is sourced to the location where receipt
278 by the purchaser (or the purchaser's donee, designated as such by the
279 purchaser) occurs, including the location indicated by delivery
280 instructions, known to the seller.
- 281 c. When (a) and (b) do not apply, the sale is sourced to the location
282 indicated by an address for the purchaser that is available from the
283 business records of the seller that are maintained in the ordinary
284 course of the seller's business when use of this address does not
285 constitute bad faith.
- 286 d. When (a), (b), and (c) do not apply, the sale is sourced to the location
287 indicated by an address for the purchaser obtained during the
288 consummation of the sale, including the address of a purchaser's
289 payment instrument, if no other address is available, when use of this
290 address does not constitute bad faith.
- 291 e. When none of the previous rules of (a), (b), (c), or (d) apply, including
292 the circumstance where the seller is without sufficient information to
293 apply the previous rules, then the location will be determined by the
294 address from which the digital good was first available for transmission

295 by the seller or the service was provided (disregarding for these
296 purposes any location that merely provided the digital transfer of the
297 product sold).

298 f. Notwithstanding the previously stated rules, a business purchaser
299 knowing at the time of its purchase of a digital good or a service that
300 the digital good or service will be concurrently available for use in more
301 than one jurisdiction shall deliver to the seller in conjunction with its
302 purchase a form disclosing this fact ("Multiple Points of Use or MPU"
303 Exemption Form).

304 1. Upon receipt of the MPU Exemption Form, the seller is
305 relieved of all obligation to collect, pay or remit the
306 applicable tax and the purchaser shall be obligated to
307 collect, pay, or remit the applicable tax on a direct pay
308 basis.

309 2. A purchaser delivering the MPU Exemption Form may
310 use any reasonable, but consistent and uniform,
311 method of apportionment that is supported by the
312 purchaser's business records as they exist at the time
313 of the consummation of the sale.

314 3. The MPU Exemption Form will remain in effect for all
315 future sales by the seller to the purchaser (except as to
316 specific apportionment that is governed by the facts
317 existing at the time of the sale) until it is revoked in
318 writing.

319 g. The terms "receive" and "receipt" mean the purchaser taking actual
320 possession of tangible personal property, first use of services, or the
321 purchaser's actual possession or purchaser's first use of digital goods
322 whichever comes first, excluding possession or first use by a shipping
323 company.

324 h. This section is reserved for a specific sourcing rule applicable to
325 telecommunications and possibly additional specific sourcing rules for
326 other services as necessary to effect the intent of providing for uniform
327 sourcing of transactions. Until the specific sourcing rule for
328 telecommunications is adopted, the sourcing rules presently applicable
329 to telecommunications will remain in effect in each State.

330

331 **312 UNIFORM DEFINITIONS**

332

333 A. Nothing in this agreement shall be construed to require any member state to
334 tax or not tax any item or service, except that a member state must use the
335 definitions specified by the Agreement if it chooses to tax or not tax the items or
336 services covered by those definitions. Each State may create an exemption for a
337 particular definition, a set of definitions, or all. A State must include all items
338 within the definitions as provided herein. A member state may not vary from any
339 definition except as otherwise specifically provided by this Agreement. The terms

340 "includes" and "including" when used in a definition contained in this section does
341 not exclude other things otherwise within the meaning of the term defined.

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B. CLOTHING AND RELATED ITEMS

1. **"Clothing"** shall mean all human wearing apparel suitable for general use.
The following list is intended to be examples and not an all inclusive list of possibilities.

a. Clothing shall include:

1. Aprons, household and shop
2. Athletic supporters
3. Baby receiving blankets
4. Bathing suits and caps
5. Beach capes and coats
6. Belts and suspenders
7. Boots
8. Coats and jackets
9. Costumes
10. Diapers (children and adults - including disposables)
11. Ear muffs
12. Footlets
13. Formal wear
14. Garters and garter belts
15. Girdles
16. Gloves and mittens for general use
17. Hats and caps
18. Hosiery
19. Insoles for shoes
20. Lab coats
21. Neckties
22. Overshoes
23. Pantyhose
24. Rainwear
25. Rubber pants
26. Sandals
27. Scarves
28. Shoes and shoe laces
29. Slippers
30. Sneakers
31. Socks and stockings
32. Steel toed shoes
33. Underwear
34. Uniforms, athletic and non-athletic
35. Wedding apparel

386

b. Clothing shall not include:

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1. Belt buckles sold separately

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2. Costume masks sold separately

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3. Patches and emblems sold separately

390

4. Sewing equipment and supplies (knitting needles, patterns, pins, scissors, sewing machines, sewing needles, tape measures, thimbles)

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5. Sewing materials that become part of clothing (buttons, fabric, lace, thread, yarn, zippers)

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2. The following definitions are mutually exclusive of the term "clothing" and each other.

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a. **"Clothing accessories or equipment"** shall mean incidental items worn on the person or in conjunction with clothing. The following list is intended to be examples and not an all inclusive list of possibilities.

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Clothing accessories shall include:

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404

1. Briefcases

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2. Cosmetics

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3. Hair notions, including barrettes, hair bows, hair nets, etc.

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4. Handbags

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5. Handkerchiefs

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6. Jewelry

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7. Sun glasses, non-prescription

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8. Umbrellas

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9. Wallets

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10. Watches

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11. Wigs and hair pieces

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b. **"Sport or recreational equipment"** shall mean items designed for human use and worn in conjunction with an athletic or recreational activity that are not suitable for general use. The following list is intended to be examples and not an all inclusive list of possibilities.

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Sport or recreational equipment shall include:

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1. Ballet and tap shoes

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2. Cleated or spiked athletic shoes

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3. Gloves (baseball, bowling, boxing, hockey, golf, etc.)

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4. Goggles

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5. Hand and elbow guards

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6. Life preservers and vests

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7. Mouth guards

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8. Roller and ice skates

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9. Shin guards

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- 431 10. Shoulder pads
- 432 11. Ski boots
- 433 12. Waders
- 434 13. Wetsuits and fins

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- c. **“Protective equipment”** shall mean items for human wear and designed as protection of the wearer against injury or disease or as protection against damage or injury of other persons or property but not suitable for general use. The following list is intended to be examples and not an all inclusive list of possibilities.

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Protective equipment shall include:

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- 1. Breathing masks
- 2. Clean room apparel and equipment
- 3. Ear and hearing protectors
- 4. Face shields
- 5. Finger guards
- 6. Hard hats
- 7. Helmets
- 8. Paint or dust respirators
- 9. Protective gloves
- 10. Safety glasses and goggles
- 11. Safety belts
- 12. Tool belts
- 13. Welders gloves and masks

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457 C. DELIVERY CHARGES

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459 **“Delivery charges”** means charges by the seller for preparation and delivery to
460 a location designated by the purchaser of personal property or services including,
461 but not limited to, transportation, shipping, postage, handling, crating and
462 packing.

463

464 D. FOOD AND FOOD INGREDIENTS

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- 1. **“Food and food ingredients”** means substances, whether in liquid, concentrated, solid, frozen, dried, or dehydrated form, that are sold for ingestion or chewing by humans and are consumed for their taste or nutritional value. **“Food and food ingredients”** does not include:

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- a. **“Alcoholic Beverages”** which means beverages that are suitable for human consumption and contain one-half of one per cent or more of alcohol by volume, and
- b. **“Tobacco”** which means cigarettes, cigars, chewing or pipe tobacco, or any other item that contains tobacco.

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2. The following definitions are categories within the definition of the term "food and food ingredients" and are mutually exclusive of each other.

a. **"Candy"** means a preparation of sugar, honey, or other natural or artificial sweeteners in combination with chocolate, fruits, nuts or other ingredients or flavorings in the form of bars, drops, or pieces. Candy shall not include any preparation containing flour and shall require no refrigeration.

b. **"Dietary supplement"** means any product, other than tobacco, intended to supplement the diet that:

1. Contains one or more of the following dietary ingredients:

- a. a vitamin;
- b. a mineral;
- c. an herb or other botanical;
- d. an amino acid;
- e. a dietary substance for use by humans to supplement the diet by increasing the total dietary intake; or
- f. a concentrate, metabolite, constituent, extract, or combination of any ingredient described in above; and

2. Is intended for ingestion in tablet, capsule, powder, softgel, gelcap, or liquid form, or if not intended for ingestion in such a form, is not represented as conventional food and is not represented for use as a sole item of a meal or of the diet; and

3. Is required to be labeled as a dietary supplement, identifiable by the "Supplement Facts" box found on the label and as required pursuant to 21 C.F.R §101.36.

c. **"Prepared food intended for immediate consumption"** means food prepared by the seller. For the purposes of this definition, "prepared" means to (1) heat, or (2) mix or combine two or more food ingredients for sale as a single item. For the purposes of this section, "prepared" does not mean to only slice, repackage, or pasteurize.

d. **"Soft drinks"** means non-alcoholic beverages that contain natural or artificial sweeteners. Soft drinks do not include beverages that contain:

- 1. milk or milk products;
- 2. soy, rice or similar milk substitutes; or
- 3. greater than fifty percent of vegetable or fruit juice by volume.

E. PURCHASE PRICE

"Purchase price" applies to the measure subject to use tax and has the same meaning as "sales price".

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F. RETAIL SALE

“Retail sale” or “sale at retail” means any sale for any purpose other than for resale.

G. SALES PRICE

1. “Sales price” applies to the measure subject to sales tax and means the total amount or consideration, including cash, credit, property, and services, for which personal property or services are sold, leased, or rented, valued in money, whether received in money or otherwise, without any deduction for the following:

- a. The seller's cost of the property sold;
- b. The cost of materials used, labor or service cost, interest, losses, all costs of transportation to the seller, all taxes imposed on the seller, and any other expense of the seller;
- c. Charges by the seller for any services necessary to complete the sale, including delivery and installation charges; and
- d. The value of exempt personal property given to the purchaser where taxable and exempt personal property have been bundled together and sold by the seller as a single product or piece of merchandise.

2. States may exclude from the sales price the amounts received for charges included in paragraphs (c) and (d) above, if they are separately stated on the invoice, billing or similar document given to the purchaser.

3. “Sales price” shall not include:

- a. Discounts, including cash, term, or coupons that are not reimbursed by a third party that are allowed by a seller and taken by a purchaser on a sale;
- b. Interest, financing, and carrying charges from credit extended on the sale of personal property or services, if the amount is separately stated on the invoice, bill of sale or similar document given to the purchaser; and
- c. Any taxes legally imposed directly on the consumer that are separately stated on the invoice, bill of sale or similar document given to the purchaser.

314 ADMINISTRATION OF EXEMPTIONS

a. To reduce the complexity and administrative burden of transactions exempt from sales or use tax, the following provisions must be followed when a purchaser claims an exemption:

- 568 1. The seller must obtain identifying information of the purchaser and
569 the reason for claiming a tax exemption at the time of the purchase
570 as determined by the member states acting jointly.
571 2. A purchaser is not required to provide a signature to claim an
572 exemption from tax unless a paper certificate is used.
573 3. The seller must use the standard form for claiming an exemption
574 electronically as adopted jointly by the member states.
575 4. The seller must obtain the same information for proof of a claimed
576 exemption regardless of the medium in which the transaction
577 occurred.
578 5. A member state may utilize a system wherein the purchasers
579 exempt from the payment of the tax are issued an identification
580 number which must be presented to the seller at the time of the
581 sale.
582 6. The seller must maintain proper records of exempt transactions and
583 provide them to a member state when requested.
584
585 b. The member states agree to hold sellers that follow the requirements of this
586 section harmless for the tax if it is determined that the purchaser improperly
587 claimed an exemption and to hold the purchaser liable for the nonpayment of tax.
588

589 **316 UNIFORM TAX RETURNS**

590
591 To reduce the complexity and administrative burden of preparing and filing sales
592 and use tax returns, all member states must:

- 593
594 a. Require that only one return per taxing period per seller be filed for the
595 State and all the taxing jurisdictions within the State.
596 b. Require that returns be due no sooner than the 20th day of the month
597 following the month in which the transaction occurred.
598 c. Allow any Model 1, Model 2, or Model 3 seller to submit its sales and
599 use tax returns in a simplified format which does not include more data
600 fields than permitted by the member states acting jointly. States may
601 require additional informational returns to be submitted not more
602 frequently than every six months under a staggered system developed
603 jointly by the member states.
604 d. Allow any seller that is registered under this Agreement, which does
605 not have a physical presence in the member state as described in
606 Article IV, and is not a Model 1, 2, or 3 seller to submit its sales and
607 use tax returns as follows:
608 1. Upon registration, the State must provide to the seller
609 the returns required by that State.
610 2. A member state may require a seller to file a return
611 within one (1) year of the month of initial registration and
612 additional returns maybe required to be filed in the same
613 month in succeeding years.

- 614 3. In addition to the returns required in paragraph (d)(2) of
615 this section, a State may require sellers to submit
616 returns in the month following any month in which they
617 have accumulated state and local tax funds for a State
618 of \$1,000 or more.
- 619 e. Participate with other member states in developing a more uniform
620 sales and use tax return form that, when completed, would be
621 available to all sellers.
- 622 f. Require, at each member state's discretion, all Model 1, 2, and 3
623 sellers to file returns electronically. It is the intent of the member states
624 that all member states have the capability of receiving electronically
625 filed returns by January 1, 2003.

626
627 **318 UNIFORM RULES FOR DEDUCTIONS OF BAD DEBTS**
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629 In order to reduce the complexity and administrative burden of taking a deduction
630 for bad debts incurred by a seller, the member states must:

- 631
- 632 a. In computing the amount of tax due, allow a seller to deduct bad debts
633 from the total amount upon which the tax is calculated for any return.
634 Any deduction taken or refund paid which is attributed to bad debts
635 shall not include interest.
- 636 b. Define for purposes of this section, "bad debt" to mean any portion of
637 the purchase price of a transaction that a seller has reported as
638 taxable and for which the seller legally claims as a bad debt deduction
639 for federal income tax purposes. Bad debts include, but are not limited
640 to, worthless checks, worthless credit card payments, and uncollectible
641 credit accounts. Bad debts do not include financing charges or interest,
642 sales or use taxes charged on the purchase price, uncollectible
643 amounts on property that remain in the possession of the seller until
644 the full purchase price is paid, expenses incurred in attempting to
645 collect any debt, debts sold or assigned to third parties for collection,
646 and repossessed property.
- 647 c. Allow bad debts to be deducted within twelve months following the
648 month in which the bad debt has been charged off for federal income
649 tax purposes. For purposes of this paragraph, "charged off for federal
650 income tax purposes" includes the charging off of unpaid balances due
651 on accounts as uncollectible, or declaring as uncollectible such unpaid
652 balance due on accounts in the instance of a seller who is not required
653 to file federal income tax returns.
- 654 d. Require that if a deduction is taken for a bad debt and the seller
655 subsequently collects the debt in whole or in part, the tax on the
656 amount so collected must be paid and reported on the return filed for
657 the period in which the collection is made.

- 658 e. Allow a seller to obtain a refund of tax on any amount of bad debt that
659 exceeds the amount of taxable sales within a twelve month period
660 defined by that bad debt.
- 661 f. Where a seller's filing responsibilities have been assumed by a
662 certified service provider, allow the service provider to claim, on behalf
663 of the seller, any bad debt allowance provided by this section. The
664 CSP must credit or refund the full amount of any bad debt allowance or
665 refund received to the seller.
- 666 g. Provide that for the purposes of computing a bad debt deduction or
667 reporting a payment received on a previously claimed bad debt, any
668 payments made on a debt or account are applied first to the price of
669 the property or service and sales tax thereon, proportionally, and
670 secondly to interest, service charges and any other charges.

671 **320 UNIFORM RULES FOR REMITTANCES OF FUNDS**

672 To reduce the complexity and administrative burden of remitting funds to the
673 states, the member states agree to:

- 674 a. Require only one remittance per return except as provided in
675 this paragraph. If any additional remittance is required, it may only be
676 required from sellers that collect more than \$30,000 in sales and use
677 taxes in the State during the preceding calendar year as provided
678 herein. The amount of the additional remittance must be determined
679 through a calculation method rather than actual collections, and must
680 not require the filing of an additional return.
- 681 b. Require, at each member state's discretion, all remittances
682 from sellers under Models 1, 2, and 3 to be remitted electronically.
- 683 c. Allow for electronic payments by both ACH Credit and ACH
684 Debit.
- 685 d. Provide an alternative method for making "same day"
686 payments if electronic funds transfer fails.
- 687 e. Provide that if a due date falls on a legal banking holiday in a
688 member state, the taxes are due to that state on the succeeding
689 business day.
- 690 f. Require that any data that accompanies a remittance be
691 formatted using uniform tax type and payment type codes approved by
692 the member states acting jointly.

693 **322 CONFIDENTIALITY AND PRIVACY PROTECTIONS**

- 694 a. The purpose of this section is to set forth the member states' policy for the
695 protection of the confidentiality rights of all participants in Models 1, 2 and 3
696 and of the privacy interests of consumers who deal with Model 1 sellers.