Streamlined Sales and Use Tax Agreement: Is Your Business Ready for Compliance?

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STREAMLINED SALES AND USE TAX AGREEMENT: IS YOUR BUSINESS READY FOR COMPLIANCE?

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ABSTRACT

As electronic commerce grows, states continue to lose tax revenue from vendors who fail to collect taxes on goods sold over the Internet. The problem has become so severe that 44 states and the District of Columbia are working on legislation, known as the Streamlined Sales and Use Tax Agreement, to simplify collection of taxes from Internet vendors. The Agreement simplifies rates and requires businesses to collect taxes when selling goods in remote locations. Businesses need to pay particular attention to this new Agreement for two reasons. First, it is likely to become law in nearly every state, and second, it requires businesses to pay back taxes on goods sold over the Internet if they fail to meet the requirements of its amnesty provision.

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INTRODUCTION

The increasing popularity of electronic commerce has created a host of tax collection problems. In many instances, retailers that sell both traditional merchandise and digital goods such as games, computer programs, and various other products and services online (“e-retailers”), sell them throughout the country without collecting taxes on the goods. E-retailers point to the fact that collecting sales and use taxes from every buyer would require them to satisfy over 7,600 tax codes. States on the other hand are concerned with the estimated $3.8 billion in revenue losses annually that stem from e-retailers’ failure to collect sales and use taxes. In response to this loss of tax revenue, beginning in October 2005 ten or more states representing at least one-fifth of the United States population met requirements outlined by the Streamlined Sales and Use Tax Agreement (“SSUTA”) and thereby gave effect to the Agreement. The SSUTA encompasses only sales and use taxes. This Article explains several important provisions of the SSUTA and explores their implications for businesses that sell goods over the Internet.

STREAMLINED SALES AND USE TAX OVERVIEW

The Streamlined Sales Tax Project (“SSTP”) was organized in March 2000. Its members consisted of state legislatures, members of local governments, and...
representatives from various business sectors. On December 22, 2000, the group approved the Uniform Sales and Use Tax Administration Act ("USUTAA"), which would later become known as the SSUTA. This Act is the model act that states must adopt if they are to take part in the project.

The objective of the SSTP is to simplify sales and use taxes by limiting states to one sales tax rate per state, plus one sales tax per local jurisdiction, with the possibility of an additional rate for food and drugs. The SSTP seeks to accomplish this goal by providing states with a “Streamlined Sales Tax System” that includes the following seven features:

1) uniform definitions within tax laws; 2) rate simplification; 3) state level tax administration of all state and local sales and use taxes; 4) uniform sourcing rules; 5) simplified exemption administration for use- and entity-based exemptions; 6) uniform audit procedures; and 7) state funding of the system.

CURRENT STATUS OF IMPLEMENTATION AMONG STATES

Originally, 34 States and the District of Columbia were involved in the SSTP project. That group has now grown to 44 states. In order for states to participate they must enact the Streamlined Sales and Use Tax Agreement and conform to its provisions. The Agreement was scheduled to take effect “on the first day of a calendar quarter at least sixty days after the tenth state is found in compliance.” With this threshold met in mid-2005, the SSUTA took effect on October 1, 2005. Additional states can sign on by bringing their states’ laws into compliance with the SSUTA. Different states are currently in various stages of compliance and their progress is tracked on the SSUTA website.

NUTS AND BOLTS OF TAX COLLECTION UNDER THE SSUTA

Determining Taxable Transactions

Section 310(A) of the SSUTA outlines five rules for determining whether an online retail sale is taxable, a process known as “sourcing” the sale. Once the source is determined, the source’s sales tax rate is then applied to the sale. The SSUTA requires that when a purchaser picks up a product at the seller’s place of business “the sale is sourced to that business location.” If the product is not picked up at the seller’s business location, and the location where the buyer receives the product is known to the seller, the sale is sourced to the location of receipt. If neither of the first two rules apply, the sale is sourced to an alternate location of the buyer based upon the seller’s records. If the first three rules do not apply, the sale is sourced to the buyer’s billing address. Finally, if the seller does not have sufficient information to apply any of the preceding four rules, and the product is tangible, the sourcing location is to be determined by the address from which the product was shipped. Alternatively, if the product is intangible and delivered electronically, as with computer software or other digital goods, the sourcing location is determined to be the location where the good was first available for transmission by the seller. If a service has been purchased, the sourcing location is the place from which the service was provided.

The above framework will require most e-retailers to collect sales and use taxes according to the address to which the goods were shipped. If taxes cannot be collected based on the shipping address, then the tax rate of the billing address will most likely be applied. Nevertheless, businesses must avoid oversimplification and carefully the SSUTA’s five-part rule whenever a transaction’s taxability is not apparent.

Tax Collection

As the SSUTA generally requires businesses to collect sales and use taxes based on where goods are delivered instead of where goods are sold, collection of taxes is an important component to the project. SSUTA § 403 sets forth three models for the
collection of taxes. Businesses are free to choose any of the three models, but the size of the business and the resources available to implement the three models are likely to be determinative. Common to all three models is the use of software that accesses a database of taxable and exempt items and assigns the proper tax rate to a given transaction based on the purchased items. The three models are otherwise distinguishable as follows:

<8> Under Model 1 the seller "selects a [Certified Service Provider] as an agent to perform all the seller's sales or use tax functions, other than the seller's obligation to remit tax on its own purchases."19. In this scenario, a third-party Certified Service Provider will sort sales, compute the tax and remit the tax for a seller.20 This option relieves sellers of various duties. In a sense, the CSP under Model 1 functions similar to an accounting firm preparing tax returns.

<9> Under Model 2 the seller "selects a [Certified Automated System] to use, which calculates the amount of tax due on a transaction."21. This scenario will likely be the most common, as businesses will buy software that has been approved by the SSTP governing board22 and will process their own sales tax returns. The primary advantage of Model 2 is cost. The software in development is designed to be easy to use and inexpensive for small businesses.

<10> Finally, under Model 3 the seller "utilizes its own proprietary automated sales tax system that has been certified as a [Certified Automated System]."23 This option is geared toward large nationwide sellers that have developed their own proprietary sales tax software. Companies such as Amazon.com, with high volumes of geographically-dispersed sales and complicated operations, are likely to take advantage of this model.

<11> Because there are costs associated with each of the tax collection models, some states are offering ways for businesses to recover their costs. These states pay for the software system design, but do not pay the costs of implementation of the software and any administrative issues that arise to the individual businesses. The SSTP governing board does not set forth an official method for recouping tax-collection implementation costs. At least one state, Michigan, is allowing businesses to defray the cost of the software by allowing businesses to keep a "small percentage"24 of the sales tax to be remitted. If the vendor does not collect the money intended to defray the costs associated with the SSUTA within 24 months of the state ratifying the SSUTA, it is forfeited.

SSUTA'S 12-MONTH AMNESTY PROVISION: INCENTING COMPLIANCE

<12> With minor exceptions, businesses that comply with the SSUTA within 12 months of a given state's SSUTA adoption are granted amnesty; hence, they are not required to pay uncollected sales and use taxes for sales made when the seller was not registered.25 Compliance is achieved for purposes of § 402 amnesty when 1) the seller registers within one year after the effective date of a state's participation in the SSUTA, and 2) the seller collects and remits state and local sales and use taxes on purchases in that state for at least 36 months following the seller's registration date. The SSUTA's amnesty provision does not apply to companies that have been contacted about a tax audit related to sales or use tax, sales taxes on goods or services purchased by a business, or any other taxes.26

<13> Businesses should take advantage of the amnesty provision. If a business acts in good faith and in accordance with the SSUTA, it can save a substantial amount of money. Some businesses might mistakenly read § 402 as allowing them to not collect taxes on sales in a state until their business conducts a sufficient volume of sales in that state. This is not so, however, as states should interpret the 12-month window for amnesty to begin once the state enacts the SSUTA. Failure to qualify for amnesty will carry a heavy cost. In some states, businesses that fail to take advantage of the amnesty provision will face a "50 percent increase in normal penalties, plus an added charge equal to 50 percent of the interest due"27 for the period that would have qualified for amnesty.

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TAX COLLECTION IS THE ONLY OPTION

E-retailers that conduct business in one of the few states that do not plan to become part of the SSUTA project should still consider collecting sales and use taxes. In Quill Corp. v. North Dakota, the United States Supreme Court held that imposition of a duty to collect use tax on Quill, an out-of-state e-retailer, was unconstitutional because, among other things, the administrative burden of collecting such a tax was too high. Over time, however, technology has become progressively less expensive and easier to install since that decision was rendered in 1992. In addition, a growing number of online retailers are voluntarily charging taxes “according to where the buyer resides.” If a business fails to collect taxes from e-commerce and attempts to rely on Quill, a court will likely find that Quill’s “rationale that administrative burdens [of collecting taxes from e-commerce] are too heavy” no longer applies because of the lower cost of technology and the growing e-retailer custom favoring tax collection.

RECENT DEVELOPMENT: THE TWO-TIER MEMBERSHIP SYSTEM

On April 16, 2005, in a successful effort to save the October 2005 goal for implementation of the SSUTA, the SSTP amended the Agreement with the creation of an “associate membership” status. With the amendment, the revised SSUTA provides for two tiers of membership among states: “Member States” and “associate members.” Those states in substantial compliance with the SSUTA are considered member states. States that have passed laws that are not yet effective, but will substantially comply with the SSUTA before January 1, 2008, are considered associate members. Associate membership affords a state the “rights and privileges of a member state,” except that an associate member “may not vote on amendments to or interpretations” of the SSUTA. In addition, associate members will be elevated to regular member status when they achieve substantial compliance with the SSUTA, or on December 31, 2007, whichever is earlier. If an associate member state is not in substantial compliance with the SSUTA by December 31, 2007, it “shall forfeit its status as an associate member.” Another provision provides that sellers do not have to collect sales and use tax on sales to parties in an associate member state “unless the seller is otherwise required to collect such taxes under applicable law.” Finally, associate member states are still required to “provide amnesty pursuant to the provisions of § 402.”

CONCLUSION

On October 3, 2005, Scott Peterson, Interim Executive Director or the SSTP, declared in a press release that the SSUTA membership prerequisites had been met, the Agreement was in effect, and states should begin working with businesses on amnesty issues. This means that e-retailers that sell goods within the early-adopting states will have to make changes mandated by law. E-retailers outside of those states should still ready themselves to collect taxes from Internet sales. Reviewing the three tax-collection models and selecting the one that best fits the business is a start. States are firmly committed to collecting some of the billions of dollars in tax revenue currently lost on e-commerce transactions. Because states are considering making companies liable for back taxes, e-retailers should start collecting e-commerce sales taxes now in order to avoid future legal problems.

PRACTICE POINTERS

- E-retailers should create a tracking system that will allow them to determine where sold goods are being shipped. If goods are sold to parties in states that have adopted the SSUTA, the business needs to apply the sourcing rules outlined in SSUTA § 310. In anticipation of the adoption of the SSUTA in other states, businesses should consider gathering the information required to
implement the SSUTA and develop or purchase software solutions that comply with the sourcing rules of SSUTA.

- Businesses should consult a Certified Public Accountant or other qualified professional when determining which of the three models for collecting taxes on Internet sales best suits their needs, then implement the optimal collection model without undue delay.

- Businesses should regularly monitor ongoing developments in the SSUTA adoption process at www.streamlinedsalestax.org/.

- Online registration for businesses will be provided through the SSUTA homepage. Businesses should be mindful of the 12-month window for amnesty in determining when to register.

- Businesses should check and see if the state into or within which they are selling is a Member State or an associate member. If the state is an associate member and no other state laws exist that would mandate tax collection, then sellers are not required by law to collect sales and use tax. However, it is highly recommended that businesses collect sales and use tax as back tax collection issues will arise when associate members become Member States.

Footnotes

1. Anthony D. Milewski Jr., University of Washington School of Law, Class of 2006. Thank you to my editors and everyone who helped me along the way with this article.


4. As of Oct. 1, 2005, 18 states are in compliance with the SSUTA including 13 full Member States and 5 associate members (the 5 states are considered to be associate member states because changes to their sales and use tax laws do not go into effect until after October 1, 2005). Full member states include Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, New Jersey, North Carolina, North Dakota, Oklahoma, South Dakota, and West Virginia. Associate member states include Utah, Tennessee, Ohio, Arkansas, and Wyoming. See http://www.ncsl.org/programs/press/2005/pr051003.htm. For a detailed list of where all fifty states stand see http://www.streamlinedsalestax.org/statestatus.pdf. The SSUTA requires that at least 10 states representing at least 20% of the U.S. population have enacted proper legislation for the SSUTA to be effective. Streamlined Sales and Use Tax Agreement (hereinafter S.S.U.T.A.) § 701, at http://www.streamlinedsalestax.org/Final%20Agreement%20As%20Amended%2011-16-04.pdf (Nov. 16, 2004). Depending on the populations of the participating states, more than 10 states may be required. S.S.U.T.A. § 701.


15. Id. § 310(A)(2).

16. Id. § 310(A)(3).

17. Id. § 310(A)(1)-(5). With regard to services, it is important to note that some states tax services in the same manner as goods.


20. Lewis, supra note 13.


23. Id.


27. Id.


32. Id. § 704(A) (amended S.S.U.T.A. on Apr. 16, 2005).

33. Id. § 704(B) (amended S.S.U.T.A. on Apr. 16, 2005).

34. Id. § 705(A) (amended S.S.U.T.A. on Apr. 16, 2005).
35. *Id.* § 705(B) (amended S.S.U.T.A. on Apr. 16, 2005).
36. *Id.*
37. *Id.* § 705(D) (amended S.S.U.T.A. on Apr. 16, 2005).
38. *Id.* § 705(F) (amended S.S.U.T.A. on Apr. 16, 2005).
39. *Id.* § 701.