

Sales & Use Tax Update

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Allegheny Tax Society

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I. National Perspective

A. 2012 Sales Tax Rate Report - Vertex Inc. (www.vertexinc.com)

- No states have changed their rates in 2012. However, effective January 1, 2013, California increased their rate from 6.250% to 6.500%.
- Indiana, Mississippi, New Jersey, Rhode Island and Tennessee have the highest state sales tax rates at 7.0000%. Minnesota has the second highest state rate at 6.8750%.
- Kodiak and Wrangell, Alaska, have the highest city sales tax rate at 7.0000%. Hoonah, AK, has the second highest rate of 6.5000%.
- Tuba City (including the surrounding areas that are in the To'Nanees'Dizi Local Government), Coconino County, AZ, has the highest combined sales tax rate of 13.7250%.
- Since 2003, there have been 2,278 new sales and use taxes, an average of 228 per year.
- Since 2003, there have been 4,237 sales and use tax changes, an average of 424 per year.
- The combined number of new and changed sales and use tax rates since 2003 is 6,515, an average of 652 per year.

B. Multijurisdictional/Internet Taxation

1. Affiliate Nexus - Requirement to collect sales tax due to an in-state affiliate being present (re: Amazon):
 - a. States with affiliate nexus legislation or rules – Arkansas, California, Colorado, Georgia, Illinois, New York, Oklahoma, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas, Utah, and Virginia (effective Sept. 1, 2013).
 - b. Colorado and Illinois – Courts have found constitutional violations in remote seller nexus legislation (*Direct Marketing Association v. Huber*, No. 10-cv-01546-REB-CBS (D. Colo. 3/30/12); *Performance Marketing Association, Inc. v. Hamer*, No. 2011 CH 26333 (Ill. Cir. Ct. Cook Cty. 5/7/12)).
2. Streamlined Sales Tax Project (SSTP) – Organized in March 2000, its objective is to simplify and modernize sales and use tax collection and administration in the United States. It arose in response to efforts by Congress to permanently prohibit states from collecting sales taxes on online commerce. Because such a ban would have serious financial consequences for states, the SSTP began as an effort to try to minimize the many differences between the sales tax policies and practices of states.
 - a. The SSUTA contains uniform provisions for (1) definitions of products and product-based exemptions; (2) rules for sourcing transactions to particular taxing jurisdictions; (3) procedures for certification of software service providers that a seller can use to determine appropriate rates and tax treatments of sales; (4) rules for bad debts and rounding; (5) requirements for tax returns; (6) electronic filing and remittance methods; and (7) rules and procedures for sales tax holidays and refunds/credits as well as shipping and handling charges. Perhaps, most importantly, the SSUTA contains a uniform rule to establish a small-seller

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- exception to the remote seller collection requirement. The bill itself does not determine the small-seller exception; rather, the SSUTA must determine it.
- b. Certified Service Providers – A system by which Internet e-commerce companies can voluntarily pay state taxes to the states in which their customers reside. The incentive the SSTP is offering companies is, rather than try to work out how much tax a company owes for each locality, they can instead use a CSP (certified service providers). In addition, "the states that are in compliance with SSUTA (Member States) will offer advantages to those sellers who use a CSP.
 - c. Member States – Currently 24 states (not California, Texas, New York, Pennsylvania, and Illinois).
3. Federal Bills to Impose Remote Seller Collection Requirements – In 2011, the U.S. House and Senate each introduced two bills to allow states to impose remote seller collection requirements if certain simplification requirements are met: the Main Street Fairness Act (both Senate and House), the Marketplace Equity Act (House), and the Marketplace Fairness Act (Senate). Whereas the Main Street Fairness Act bills are identical, there are some notable differences between the House's Marketplace Equity Act and the Senate's Marketplace Fairness Act. The Marketplace Fairness Act was reintroduced to both houses on February 13, 2013.
- a. The Main Street Fairness Act - The Main Street Fairness Act would allow any Streamlined Sales and Use Tax Agreement (SSUTA) member state to require a remote seller with no physical presence in the state to collect that state's sales or use tax on sales of both taxable goods and services into the state. The bill lists 18 minimum simplification requirements for the SSUTA and its implementation by member states. They include a centralized, multistate registration system that a seller may elect to use to register with the member states and that a seller must be able to register directly with a member state. Each member state must establish a single state-level administrative authority for sales and use taxes; maintain a common tax base throughout the state; eliminate caps and thresholds on the application of sales and use tax rates; complete a taxability matrix; relieve a remote seller from liability resulting from the seller's reliance on certain information provided by the member state; and compensate sellers for expenses incurred directly from administering, collecting, and remitting sales and use taxes to the member state.
 - b. Marketplace Equity Act - The House's Marketplace Equity Act would allow all states (both member states and nonmember states to the SSUTA) to require remote sellers of both taxable tangible personal property and services to collect and remit sales and use tax if the state implements a simplified system for administering remote seller collections. The state would be required to meet the following simplification provisions: (1) There must be a small-seller exception for remote sellers with gross annual receipts in the preceding calendar year from remote sales of items, services, and products in the United States not exceeding \$1 million or in the state not exceeding \$100,000 (states are permitted to set higher thresholds); (2) the state must provide a tax return for use by remote sellers and a single revenue authority within the state with which remote sellers are required to file the return; (3) for remote sellers, the products and services subject

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to tax must be identical throughout the state; and (4) the state must require remote sellers to collect sales and use tax under one of three rate structures: (a) a single statewide blended rate that includes both the state rate and applicable rates for local jurisdictions, as determined by the state; (b) the maximum state rate, which is the highest rate at which sellers are required by the state to collect tax, exclusive of local taxes; or (c) the applicable destination rate, which is the sum of the state rate and any applicable rate for the local jurisdiction into which the sale was made.

- c. Marketplace Fairness Act - The Senate's Marketplace Fairness Act, like the Marketplace Equity Act, would grant all states the authority to enforce existing state and local sales and use tax laws. However, SSUTA member states and nonmember states would be treated differently. Member states would simply be allowed to require remote retailers to collect state and local sales and use taxes on their sales of taxable goods and services.

Nonmember states would be able to set the same requirement so long as they adopted a number of minimum simplification requirements: (1) There must be a single state-level agency to administer all sales and use tax laws, a single audit, and a single return; (2) there must be a uniform sales and use tax base among the state and local taxing jurisdictions; (3) the collection of taxes must be based on the destination rate; (4) the nonmember state must (a) provide software and services to remote sellers and third-party providers to help them identify the destination rate; (b) provide certification procedures to providers to make the software and services available to remote sellers; and (c) hold providers harmless for errors or omissions due to information provided by the state; (5) the nonmember state must hold remote sellers using a provider harmless for any errors and omissions made by that provider; (6) the nonmember state must allow for liability relief (including penalties and interest) for tax collection errors that are due to a remote seller's reliance on information provided by the state; and (7) the nonmember state must provide remote sellers and providers with 30 days' notice of a local rate change. Local rate changes could become effective only on the first day of a calendar quarter. If a nonmember state failed to provide 30 days' notice of a local rate change, the state must hold a remote seller or provider harmless for collecting the tax at the immediately preceding effective rate during the 30-day period prior to the effective date of the new rate.

II. Pennsylvania

A. Budget

- Eliminating the capital stock/foreign franchise tax in January 2014, putting an end to Pennsylvania's role as the only state in the nation to tax both business income and business assets.
- Beginning to reduce the corporate net income tax from one of the highest rates in the nation at 9.99 percent down to 6.99 percent through a gradual, multi-year phase-down.

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- Raising the cap on net operating loss deductions from \$3 million, or 20 percent of income, to \$5 million, or 30 percent of income, to attract technology, bioscience and research companies.
- Allowing for like-kind exchanges and start-up business deductions, aligning state tax code with federal tax treatment and encouraging small business expansion.
- Repealing the corporate loans tax, ending an unjust burden placed on small businesses without access to traditional forms of lending that take loans to grow or simply pay regular business expenses. Elimination of this tax will also end a deterrent to establishing corporate headquarters in Pennsylvania.
- Simplifying the tax code and repealing nuisance taxes, eliminating a number of anti-job growth restrictions on businesses and individuals, and removing obsolete taxation and administrative provisions.

B. Cases

1. *Procter & Gamble Paper Products Company v. Commonwealth*, 29 A.3d 1221 (Pa. Cmwlth. 2011) - On October 16, 2012, the Pennsylvania Supreme Court affirmed the Commonwealth Court's decision in which the Commonwealth Court ruled that "CHEP" pallets qualify as exempt "wrapping supplies."
2. *Northeastern Pennsylvania Imaging Center v. Commonwealth* 978 A.2d 1055 (Pa. Cmwlth. 2009) - The Pennsylvania Supreme Court reversed a Commonwealth Court ruling. The Court ruled that MRI and PET/CT Scan systems keep their identity as tangible personal property upon installation, thereby making them subject to sales tax.
3. Also re MRI's, there are 2 other sales/use tax cases being litigated: 1) involves whether or not an MRI is used in a "photography" operation; 2) the other relates to construction subcontractors & whether portions of their work should remain as TPP - i.e., the Court(s) will be forced to look at numerous items installed in a construction contract and make a decision as to whether they will look at a construction contract overall or at each item installed; this could have vast ramifications for contractors.

C. Cloud Computing - Letter Ruling SUT-12-001 - Taxation of software located remotely.

D. Board of Appeals - Offers in Compromise

E. Board of Finance & Revenue - Criticized for lack of independence

1. 3-5 members, one of which is appointed by Treasury; the remaining appointed by governor and confirmed by the Senate.
2. Retain accessibility by attorneys and accountants (CPAs?) to practice before it.
3. Ability to compromise.
4. Currently rewriting legislation in cooperation with the PBA's State Tax Section and the PICPA's State Tax Committee.