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TAX RELIEF SQUABBLES

The Senate has the potential opportunity to choose between a "wholesale" one-year extension of what are referred to as the "Bush tax cuts" and a "middle class only" version. If this sounds familiar, Senate Majority Leader Harry Reid (D-NV) passed on an opportunity to consider such bills as amendments to another pending bill last week.

This time the bills are sitting on the Senate calendar as stand-alone bills. It seems unlikely the Senate will actually get to vote on the bills. It will probably end up as another "neither bill gets the sixty votes necessary to proceed" outcome.

The Republican bill, S. 3413, is straightforward. It simply extends through 2013, the Economic Growth and Tax Relief Reconciliation Act of 2001 and the Jobs and Growth Tax Relief Reconciliation Act of 2003.

It also extends the Alternative Minimum Tax (AMT) patch through 2013. The patch is the temporary increases in the income levels at which the AMT is applied. You may recall that the latest patch expired at the end of 2011 so if Congress does not do something, some of us are on the hook already for AMT for this year since the 1967 income levels apply. The Republican bill cleans up this year's exposure and takes care of next year's.

Finally, the bill extends and improves an SBLC favorite, the temporary increase in direct expensing under Section 179, through 2013. This is the provision of the tax code that allows businesses to write off equipment and machinery purchases in the first year as opposed to depreciating them as long as the business does not exceed a cap on the amount of such purchases in that year.

The Republican bill pushes the allowance back up the temporary level of 2011, which was $500,000 with an asset cap of $2 million, for 2012 and 2013.

Currently, Section 179 has stepped down to an adjusted allowance of $139,000 and the phase out of $560,000 for this year. As it stands, unless something is done, at the beginning of 2013 the amounts revert to pre-2003 levels of $25,000 and $200,000 without inflation indexing.

For the most part, the Democratic bill, S. 3412, extends the 2001 and 2003 relief through 2013 but limits to taxpayers with incomes under $250,000. It pulls the estate tax relief/repeal out of it completely (i.e. it allows the tax to revert to its pre-2001 levels of a $1 million exemption and 55 percent top rate.)

Instead of the two-year "patch" of the AMT, S. 3412 fixes it for this year only. The direct expensing allowance is increased to $250,000 for 2013 with an asset cap of $800,000.

MARKETPLACE FAIRNESS

Look for some congressional activity on an issue that has been "kicking around" since the 1960's – collection of state sales and use taxes. Senators Richard Durbin (D-IL) and Michael Enzi's (R-WY) bill, S.1832, the Marketplace Fairness Act is this Congress' version of the legislation to give states "nexus" or jurisdiction over out of state sellers to require them to collect and remit sales/use taxes. Representative John Conyers (D-MI) has introduced H.R. 2701 and Representative Steve Womack (R-AR) has introduced H.R. 3179 in the House. The bills in the House are slightly different but would accomplish the same goal. A House committee will hold a hearing on the issue this week and the Senate sponsors have been taking to the Senate floor to talk about the bill. In addition, the general media has been taking note of the fact one of the principal opponents, Amazon, has dropped its opposition.

Remote Seller Nexus

Under the structure of state taxation, sales and use taxes are actually imposed on the purchaser of goods and services. The obligation, if any, on the seller is to collect and remit the tax. A sales tax is the tax collected by a seller on a transaction which occurs in the state. The use tax is essentially a fiction created to capture the sales tax on sales made out of state. The purchaser is obligated to pay the use tax on any goods or services the purchaser buys out of state and "uses" in the state. Theoretically, the purchaser is always obligated to pay either the sales tax or the use tax. However, few purchasers voluntarily pay the use tax, and it is impossible to enforce compliance on a purchaser-by-purchaser basis. The state can force the seller to become a collector of the sales tax since it has jurisdiction over the seller and can use "leverage" such as the seizure of assets to force compliance. The word "nexus" is often used to describe the physical presence necessary for the state to assert jurisdiction over the seller. If the seller has a facility in the state, the question of jurisdiction is easily resolved. In the case of an out-of-state seller, determining whether the seller has sufficient contact with a state to warrant an obligation to collect and remit a state use tax on transactions with a purchaser residing in the state has been a source of disputes for several decades, long before the Internet.

In National Bellas Hess v. Illinois Department of Revenue (1967), the Supreme Court ruled that states could not collect a sales or use tax from a firm that did not maintain a retail outlet within the state's boundaries. In legal parlance, the company had to have "nexus," or a connection with the state, upon which the state could claim jurisdiction.

In 1992, the Supreme Court decided the Quill Corp. v. North Dakota case involving a North Dakota statute drafted to specifically circumvent the earlier National Bellas Hess case. The North Dakota statute was drafted to define nexus to include "regular or systematic solicitation of a consumer market." Regulations further defined this as three or more advertisements within a 12-month period. Justice Stevens, speaking for the Supreme Court, said: "We do not share [North Dakota's] conclusion that the ruling of Bellas Hess is no longer good law." The Supreme Court, however, did make an observation that is essential to understanding the significance of possibility of federal legislation on nexus: "Our decision is made easier by the fact that the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve. No matter how we evaluate the burdens that use taxes impose on interstate commerce, Congress remains free to disagree with our conclusions."

Concerns

The states estimate they are losing as much as $23 billion in sales and use taxes in a year.

While the issue is often perceived in terms of "Main Street" or “brick and mortar” versus the "Internet," sales and use tax law has ramifications for a wide range of businesses. In the early 2000s, a number of states decided they had to eliminate one of the fundamental objections to expanding the definition of "nexus" to allow states to force remote sellers to collect and remit use taxes. The fundamental objection was that sales and use tax regimes varied greatly from state to state, and local jurisdiction sales taxes further complicated collection and remittance.

Streamlined Sales Tax Project

On November 12, 2002, representatives of 33 states and the District of Columbia voted to approve a multi-state agreement to simplify the nation's sales tax laws by establishing one uniform system to administer and collect sales taxes on the trillions of dollars spent annually in out-of-state retail transactions. The effort is known as the Streamlined Sales Tax Project (SSTP). Under the agreement known as the Streamlined Sales and Use Tax Agreement (SSUTA), a certain number of states with a certain percentage of the population needed to be in compliance in order for the system to go into effect. That number was reached.

Twenty-four states have adopted the simplification measures in the Agreement (representing over 33 percent of the population). The following states have passed legislation to conform to the SSUTA: Arkansas, Georgia, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, Nevada, New Jersey, North

Carolina, North Dakota, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Vermont, Washington, West Virginia, Wisconsin, and Wyoming.

Forty-four states and the District of Columbia have been involved in the SSTP in one manner or another, depending on the extent of their commitment to implementation of the system. Forty-five states and the District of Columbia impose sales and use tax. The goal of the SSTP is to provide states with a Streamlined Sales Tax System (SSTS) that includes the following key features:

• Uniform definitions within tax laws. Legislatures still choose what is taxable or exempt in their state. However, participating states will agree to use the common definitions for key items in the tax base and will not deviate from these definitions.

• Rate simplification. States will be allowed one state rate and a second state rate in limited circumstances (the second rate would cover food and drugs). Each local jurisdiction will be allowed one local rate. A state or local government may not choose to tax telecommunications services, for example, at one rate and all other items of tangible personal property or taxable services at another rate. State and local governments will accept responsibility for notice of rate and boundary changes at restricted times.

• State level tax administration of all state and local sales and use taxes. Businesses will no longer file tax returns with each local government within which it conducts business in a state. Each state will provide a central point of administration for all state and local sales and use taxes and the distribution of the local taxes to the local governments. A state and its local governments will use common tax bases.

• Uniform sourcing rules. The states will have uniform and simple rules for how they will source transactions to state and local governments. The uniform rules will be destination/delivery based and uniform for tangible personal property, digital property, and services.

• Simplified exemption administration for use- and entity-based exemptions. Sellers are relieved of the "good faith" requirements that exist in current law and will not be liable for uncollected tax. Purchasers will be responsible for paying the tax, interest, and penalties for claiming incorrect exemptions. States will have a uniform exemption certificate in paper and electronic form.

• Uniform audit procedures. Sellers who participate in one of the certified SSTS technology models will either not be audited or will have limited scope audits, depending on the technology model used. The states may conduct joint audits of large, multi-state businesses.

• State funding of the system. To reduce the financial burdens on sellers, states will assume responsibility for funding some of the technology models. The states are also participating in a joint business-government study of the costs of collection on sellers.

The Agreement went into effect when 10 states comprising at least 20 percent of the population of states imposing a sales tax came into compliance. However, collection by sellers of sales and use taxes on remote sales remains voluntary under the Agreement until either Congress or the Supreme Court acts to make this collection mandatory.

<u>Federal Nexus Legislation</u>

The Senate bill is constructed around acceptance of the SSUTA by states. Under the bill, states that voluntarily are already or become Member States of the SSUTA would be able to require remote sellers to collect and remit sales and use taxes after 90 days.

States that do not wish to become members of SSUTA would be allowed to collect the taxes only if they adopt certain minimum simplification requirements and provide sellers with additional notices on the collection requirements. The requirements are similar to but not as comprehensive as the conditions SSUTA Members have accepted.

The legislation exempts sellers who make less than $500,000 in total remote sales in the year preceding the sale to qualify for an exemption and not be required to collect the tax.