

Practical Difficulties in Streamlining the Sales Tax: A View From One Industry Perspective

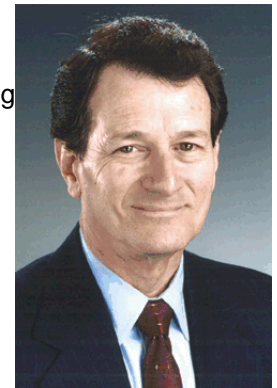
by Timothy P. Noonan and Paul R. Comeau

It seems like the Streamlined Sales Tax Project has been around forever, doesn't it? This year, like last year, federal lawmakers will ponder proposed legislation that would allow states in compliance with the now-effective Streamlined Sales and Use Tax Agreement to statutorily force remote sellers to collect sales tax on the goods they deliver into those states.¹ Whether the proponents can gather enough support to pass those bills is somewhat doubtful. That is not surprising, because the legislation would effectively overrule the U.S. Supreme Court's long-standing position that a seller have some modicum of physical presence to have nexus for sales tax purposes.² For practitioners who deal with nexus and physical presence issues on a day-to-day basis, that is one of the more interesting and unique aspects of the entire project.



In any event, even without congressional acknowledgement, the SSUTA is making strides in enticing its real targets -- printers, direct-mail marketers, Internet retailers, and other remote sellers -- into *voluntarily* collecting sales tax despite their lack of common-law nexus. The attraction? In the words of the SSUTA itself, the agreement offers tax law simplifications, more efficient administrative procedures, and emerging technologies to substantially reduce the burden of tax collection."³ The idea is that, from a tax practice perspective, the SSUTA is supposed to make things a whole lot easier.

For printers and direct marketers, however, the SSUTA's current rules may not have the desired allure. The printing industry's recent efforts to render the SSUTA's definitions and uniform sourcing rules and definitions more industry-friendly demonstrates the challenges the SSUTA's policymakers face in balancing 1) the ease of compliance and administration, with 2) consistency and pragmatism.



Indeed, although streamlining theoretically is supposed to ease tax compliance and practical burdens, the implementation of potential new policies and rules can create real headaches. For the printing and direct-mail industries, in which a single order from a customer typically places taxable property in the hands of thousands of recipients in hundreds of state and local jurisdictions, the SSUTA's *destination*-based sourcing has raised concerns. Meanwhile, a split between state and industry interests on the taxability of postage shows how a simple definition in the SSUTA can have ramifications for an entire industry.

In this article, we'll take a look into those specific issues in the interest of demonstrating that, from a tax practice perspective, "making things easier" is sometimes easier said than done.

The Streamlined Sales Tax Agreement Where It Stands

First, however, a brief update as to where things stand. The SSUTA began as an effort by state governments ostensibly to simplify and modernize the collection of sales and use taxes. Although creating uniform rules and procedures clearly presents a benefit to both the taxing states and the vendors who must collect the tax, the impetus for this multistate streamlining effort was largely to enhance the collection of sales tax collection on Internet, catalog, direct-mail, and other remote sales.⁴ By creating a streamlined, user-friendly system for collecting tax, states hoped that remote sellers not required to collect tax because of their lack of nexus would voluntarily come forward and begin collecting tax.

To date, 22 states representing 28 percent of the country's population, have enacted a sufficient amount of the SSUTA to become either full or associate members of the SSUTA Governing Board.⁵ The SSUTA became effective in October 2005, when enough states to represent 20 percent of the population had come into compliance.

The features of the SSUTA's streamlined system include:

- unified definitions of products and services;

- uniformity among state and local tax bases;
- a centralized electronic registration system shared by member states;
- simplified state and local base tax rates;
- simplification of tax returns and remittances; and
- uniform sourcing rules.

Practical Problems on Sourcing for Direct Mail

As mentioned, however, one of the major industries affected by the SSUTA is the printing/direct-mail sector. And one of the understandable concerns for that industry in the development of the SSUTA relates to the last feature of the SSUTA system mentioned above -- the rules governing the sourcing of sales. The agreement adopts a uniform destination-based approach, sourcing sales to the state where the taxable product or service is either delivered or received.⁶ Under the general provisions, a seller sources its sales by applying a hierarchy of rules based on the feasibility of determining the location of receipt for the taxable property.⁷ If the destination can't be reasonably determined using those rules, the sourcing will default to the location of the sale or shipment (origin-based).⁸

Destination-based sourcing, not surprisingly, presents a particular burden for the printing and direct-mail industries. Consider the example of a commercial printer who contracts with a catalog retailer to print 200,000 fall catalogs and deliver them to the individuals designated by the retailer -- individuals spread across hundreds of state and local jurisdictions. The SSUTA's general sourcing rules look to the final destination of the mailings themselves, and not to the purchaser's location, to determine where to source the sale. Thus, a direct-mail printer under the SSUTA is technically faced with the arduous task of determining the taxing jurisdiction and rate of every customer on the mailing list. Sourcing by reference to the mailing list itself might work if those lists were not typically confidential and fiercely protected by the companies who use direct-mail services. Often, a direct-mail purchaser will send the list on labels that the printer merely affixes to the printed materials and mails. Printers typically are not permitted to retain the mailing list for their records.

In recognition of those industry practices, the SSUTA developed special sourcing rules for direct mail.⁹ Under those rules, a purchaser of direct-mail services who does not assume the responsibility of collecting the tax itself (by presenting an exemption certificate) must provide the printer or direct-mail seller with information on the jurisdictions where its recipients are located.¹⁰ If the seller collects the tax based on that information, it is relieved of any further obligations on the transaction (that is, free from audit), as long as no bad faith is involved.¹¹

Essentially, then, it is up to the direct-mail purchaser to either remit the tax on its own or to provide jurisdictional information to the seller so the seller may collect and remit the tax. If the purchaser fails to provide an exemption certificate or the required information to the seller, the seller must revert to the SSUTA's general sourcing rules. And under those rules, when the seller cannot pinpoint the locations of each recipient, the sale will generally be sourced either to the purchaser's location (often in a state that has little connection with where the mailings wind up) or to the origin of the sale, the SSUTA's default. In either of those two scenarios, the purchaser runs the risk of double taxation: If the tax is sourced to and collected at either the seller's or purchaser's location, what happens if the states where the mail is delivered seek to collect a use-based tax based on the receipt of taxable property? Nothing in the SSUTA requires a member state to provide a credit for taxes collected by another state on the same transaction, whether the tax was a result of the SSUTA's default (origin) sourcing rules or if a nonmember state collected on an origin-of-sale basis. Meanwhile, nothing in the SSUTA instructs sellers on what form its jurisdictional information to the seller must take or what allocation methods would be acceptable.¹²

The printing industry has also lobbied (apparently with some success) to change the definition of direct mail to distinguish between "advertising and promotional mail" and more routine business correspondence such as billing invoices, account statements, shareholder communications, and payroll mailings. An amendment on the agenda at the SSUTA Governing Board's next meeting December 11 and 12 would change the definition, leaving only advertising and promotional mail subject to the special sourcing rules for direct mail.¹³ That, in effect, would allow companies that print and mail account statements, billing materials, and so forth on behalf of other companies to source the service simply to the purchaser's location, rather than sourcing to the mailboxes as with promotional material. That sounds simple, but even the proposed amendment itself raises additional questions: What happens, for instance, if a company that contracts with a printer to print and mail billing statements wants to insert an advertising brochure into the mailing? Does this "poison" the package and require the use of recipient-based sourcing?

Those types of issues are debated regularly at the advisory level, at which the state officials constituting the SSUTA's State and Local Advisory Council (SLAC) and the industry representatives making up the Business Advisory Council (BAC) attempt to strike a balance between state and business-community interests. And they show that the push to make things simpler can impose a practical burden on industry members and their customers.

The Postage Debate

One of the most intense debates for the printing and direct marketing industries has been waged over the SSUTA's treatment of postage and other "delivery charges." Because direct marketing companies often provide a bundled service that includes both printing and mailing the materials requested by the purchaser, a state's inclusion (or decision not to exclude) postage in the sale price subject to tax can have an enormous impact.

As an illustration, imagine a small retail business that contracts with a direct-mail printer to print and deliver 20,000 copies of a simple sales-event flyer. While it may cost only 5 cents a copy for the printer to create the flyer, each flyer will cost 41 cents to mail. In a state that excluded postage from the taxable sales price (assuming a sales tax rate of 7 percent), the taxable cost for the service would be \$1,000, with \$70 in sales tax due. If postage is included in the taxable sales price, that same \$1,000 in printing work would result in \$714 in sales tax.

Under the SSUTA, the sales price of a product or service is defined to include delivery charges.¹⁴ Meanwhile, delivery charges are defined to include "transportation, shipping, postage, and similar charges."¹⁵ The SSUTA allows states the option to exclude postage and other delivery charges from the sales price; however, a review of the legislation of the 22 states reveals that 8 of the member states have thus far chosen not to exempt those charges. In fact, two member states have actually imposed a tax on direct-mail postage since the SSUTA was first released.¹⁶ The fear among printers and direct mailers is that the current inclusion of postage and delivery charges with the option to *exclude* them (a "toggle-out" approach) will cause other states joining the compact to simply adopt the language of the SSUTA without taking the next step and enacting an exemption, especially if Congress formally recognizes the agreement in its current form.

The BAC and the SLAC differ on that issue, with the BAC seeking an amendment that would exempt delivery charges but allow states to adopt language imposing a tax on those charges (a "toggle-in" approach). The SLAC has proposed an amendment retaining the toggle-out approach but emphasizing that the exemption for delivery charges, if adopted by a state, would apply to all direct mail, not only promotional and advertising mail. The SSUTA itself stresses that the agreement "shall not be construed as intending to influence a member state to impose a tax on or provide an exemption from tax for any item or service." Yet printers believe a simple switch from a toggle-in to a toggle-out approach on postage may do just that.

Conclusion

Until and unless Congress officially recognizes the SSUTA, those issues will continue to be matters of policy for states who have implemented the agreement and those who are considering legislation to bring themselves within compliance. And whenever that happens, we'll find practical difficulties in determining and complying with the positions taken by different states. Some states, for example, have resisted the change from origin-based to destination-based sourcing. But if Congress finally grants the statutory power to SSUTA-compliant states to impose taxes on remote sellers, the wording of the agreement can be expected to have a large impact on how fence-sitting states legislate to bring themselves into the compact to reap its benefits. The issues facing the printing and direct-mail industries demonstrate that the SSUTA, despite its benefits of simplification and uniformity, can raise its own set of administrative problems and issues that companies and tax professionals will have to face.

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This article is by Timothy P. Noonan and Paul R. Comeau of Hodgson Russ LLP, Buffalo. Mr. Noonan wishes to acknowledge Joshua K. Lawrence, who is currently a law clerk -- and soon to be a new associate -- in Hodgson Russ's state and local tax group, for his help in putting together this article.

FOOTNOTES

¹ Two bills "to promote the simplification and fairness in the administration and collection of sales and use taxes" are currently in committee: S. 31, introduced by U.S. Sen. Michael Enzi, R-Wyo., and H.R. 3396, introduced by U.S. Rep. William Delahunt, D-Mass.

² See *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

³ Streamlined Sales and Use Tax Agreement at section 102.

⁴ See, for example, "Streamlining New York's Sales Tax: Examining Requirements for Compliance With the Streamlined Sales and Use Tax Agreement," New York State Department of Taxation and Finance, Office of Tax Policy Analysis, Oct. 2006.

⁵ The full members are Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, New Jersey, North Carolina, North Dakota, Oklahoma, Rhode Island, South Dakota, Vermont, and West Virginia. Associate members, whose enacting legislation either takes effect in 2008 or who still must enact provisions to qualify for full membership, are Arkansas, Nevada, Ohio, Tennessee, Utah, Washington, and Wyoming.

⁶ See SSUTA section 310(A).

⁷ *Id.*

⁸ See SSUTA section 310(A)(5).

⁹ See SSUTA section 313.

¹⁰ See SSUTA section 313(A)(1), (2).

¹¹ See SSUTA section 313(A)(2).

¹² See SSUTA section 313(B).

¹³ See "SLAC Amendment to Amend and Re-title Section 313," Governing Board Document AM07034, *available at* <http://streamlinedsalestax.org>, click link to "Meetings and Materials." The SSUTA's current definition of direct mail includes "any printed material delivered or distributed by United States Mail or other delivery service to a mass audience or to addresses on a mailing list provided by the purchaser or at the direction of the purchaser when the cost of the items are not billed directly to the recipients."

¹⁴ See SSUTA Appendix C, Pt. 1.

¹⁵ *Id.*

¹⁶ See N.J. Stat. Ann. section 54:32B-2; Ohio Rev. Code Ann. section 5739.01(H)(1)(a)(iv).