Relief from Effects of “Amazon” Laws - Multistate Tax Commission Voluntary Disclosure

by

Betty J. Williams[1] and Ulises Pizano-Diaz[2]

Given the current economic climate and the ever increasing global nature of business, states are turning their focus on out-of-state businesses for previously untapped sources of revenue. As a result, states are closely scrutinizing “nexus” with out-of-state businesses, making more taxpayers liable for state taxes in jurisdictions beyond their state of residence. Nexus describes the amount and degree of business activity that must be present before a state can tax an entity's income. If a taxpayer has nexus in a particular state, the taxpayer must pay and remit taxes in that state. The unwary business owner may not even realize he has a filing duty in other states and that tax, interest and penalties may be accumulating. The Multistate Tax Commission Voluntary Disclosure (MTC) allows taxpayers with potential liability in multiple states to negotiate a settlement agreement regarding back liability on favorable terms through a single point of contact and a single uniform procedure.

Many businesses are under the impression that nexus, and state tax or information filing requirements, are established only when they open a store or office in a particular state. This, however, is not true. In the area of use tax collection a business can avoid establishing nexus with a state if it stays within the "safe harbor for vendors ‘whose only connections with customers in the [taxing] State is by common carrier or the United States mail.’" *Quill Corp. v. North Dakota*, 504 U.S. 298, 315 (1992) However, many businesses do more than just ship their products by common carrier, they often use in-state permanent or temporary employees, traveling salesmen, independent contractors (full-time or part-time), maintain inventory, or lease property to customers in other states. As a result, they unknowingly create the possibility of state tax obligations for themselves.

Taxpayers doing business in multiple parts of the country are often unaware of their state filing requirements. Unfortunately for the unwary taxpayer, if the state finds the taxpayer first, there may be no statute of limitations and tax may be calculated from the day when the taxpayer is deemed to have started doing business in that state. In addition to the tax, taxpayers expose themselves to the potential assessment of penalties and interest, which may wind up being more than the tax itself.

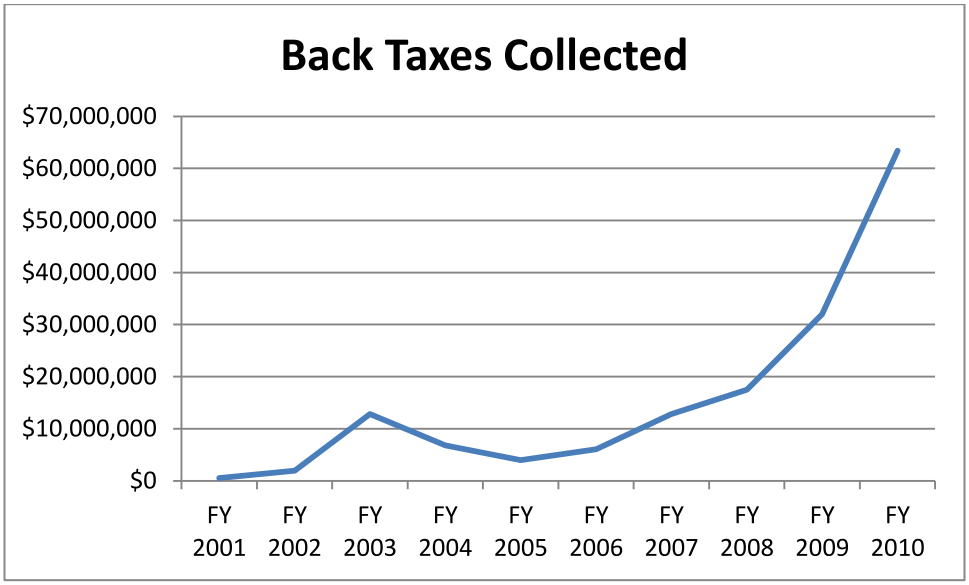
It is often hard enough to navigate a single state’s maze of tax regulations, filing requirements and procedures, much less having to comply with the requirements of numerous states. The Voluntary Disclosure Program eases the burden of coming into compliance in multiple states for non-filers. All but six states participate in the program; New Mexico, Illinois, Pennsylvania, Delaware, Nevada and New York do not participate. The program allows a tax non-filer with potential liability in multiple states (including the District of Columbia) to negotiate a settlement regarding back liability on favorable terms through a single point of contact and a single uniform procedure.

---

[1] Betty Williams is the Managing Shareholder at The Law Office of Williams & Associates, PC, in Sacramento, California. She may be reached at (916) 488-8501 www.WilliamsLawAssociates.com
[2] Ulises Pizano is an Associate at The Law Office of Williams & Associates, PC.

States offer this service through the MTC because it is sometimes unclear how nexus applies to a particular taxpayer or situation, which often results in a taxpayer's failure to fulfill his state filing requirements. The MTC sets aside the issue of nexus, and focuses on compromise, clearing up uncertainty about past tax periods. By using the MTC, taxpayers will find the multi-state voluntary disclosure to be faster and more efficient than filing voluntary disclosure in each separate state.

Participation in the Voluntary Disclosure Program has skyrocketed in recent years. In 2002, revenue generated by the program was under $10 M while the 2010 figure was well in excess of $60 M.



All States	Back Taxes Collected[3]
FY 2001	$515,516
FY 2002	$1,958,122
FY 2003	$12,811,593
FY 2004	$6,821,834
FY 2005	$3,974,733
FY 2006	$6,085,684
FY 2007	$12,799,098
FY 2008	$17,468,156
FY 2009	$31,964,967
FY 2010	$63,396,870

Many types of tax administered by the states are eligible. The most common types of tax or revenue eligible are sales/use tax and the various business activity taxes such as income tax, franchise or withholding tax. Generally, contact with a state with respect to a type of tax disqualifies that taxpayer from participation in the Voluntary Disclosure Program if the contact includes filing a return, paying a tax, or receiving an inquiry from the state regarding the type of tax at issue

The key features of the Voluntary Disclosure Program:

- **Taxpayer will file and pay tax and interest with respect to the "Lookback Period."** The state will waive all penalties and all tax prior to the "Lookback Period." The "Lookback Period" is determined by individual state policy. Many states generally have a three year lookback period. The material terms of the voluntary disclosure settlement, including the "Lookback Period" and waiver of penalty will be identical whether the taxpayer applies to the states directly or through the multi-state program. Once the voluntary disclosure is made, the state will expect the taxpayers to maintain their compliance unless there is a material change in the taxpayers' nexus status.
- **The MTC voluntary disclosure is confidential.** During the voluntary disclosure process, the taxpayer identity is not known to the state or MTC, the taxpayer is identified only by case number. The taxpayer's identity will not be disclosed until a legally binding voluntary disclosure contract has been completed. Even when the voluntary disclosure contract is signed, the MTC and state are required to perpetually maintain the taxpayer's confidentiality as a voluntary disclosure participant. Further, the taxpayer has a right to

[3] Multistate Tax Commission, Nexus Director's Report, p. 7, July 27, 2010

withdraw from the Voluntary Disclosure Program at any time, and the MTC is precluded from sharing any confidential information with the state or Internal Revenue Service.

Through the MTC Voluntary Disclosure Program, businesses may approach a large number of states anonymously to propose settlement of potential state sales/use tax or income/franchise tax liabilities arising from past activities within those states. Taxpayers benefit because they do not have to worry about complying with numerous procedural hurdles established by each individual state. Further, the taxpayer gets the opportunity to address potential state tax disputes before the state issues prior-year assessments of taxes, interest, and penalties.

If a taxpayer is currently under audit by one state, but wishes to participate in the Voluntary Disclosure Program, they may still be able to do so. The taxpayer, however, would first have to anonymously disclose to the prospective states that they are currently under audit by another state. At that point, it is up to the prospective state whether they want to accept the taxpayer into the Voluntary Disclosure Program.

As globalization, free trade, and the information revolution enable individuals and businesses to freely move money, ideas, products, and know-how nearly instantaneously, states will increasingly look to tax these businesses. This program brings to light the need for fair, even-handed and consistent state tax enforcement, and the need to establish federal and state cooperation in the administration of state tax issues. The MTS is merely but one several programs that help guide these taxpayers through the labyrinth of multistate tax issues.

<u>Uncertainty with “Amazon” Laws</u>

Retailers who sell merchandise over the internet may consider whether MTC is a viable option if states are successful enacting “Amazon” laws. Since 2008, 10 states have passed an “Amazon” law attempting to collect tax on sales made by Internet retailers with marketing affiliates who ship orders to their home state address. New York was first to pass such a law which sent Overstock running and Amazon to court.

As described above, retailers have historically only been required to collect sales tax when sales were shipped to addresses in states where the retailer had a physical presence or nexus. Although consumers are required to report untaxed purchases on their individual income tax returns in many states, few actually do. Beginning with New York in 2008, states began to challenge the Internet retailers’ position by arguing that these sellers do have some type of physical presence when it has affiliates or other agents located within a state that facilitated the Internet services by advertising or linking to an online retailer’s merchandise for a commission. Amazon and Overstock are the primary targets because of their size and prominence in the marketplace, however there are many other Internet-only businesses that will be affected by future sales tax laws.

Internet retailers argue that compliance in all jurisdictions is simply too burdensome, and that since they do not receive state services in the states where they have no physical presence, they are not required to collect tax under the law. The United States Supreme Court upheld the notion that complexity in tax rates, exemption and filing requirements are simply too burdensome in *National Bellas Hess, Inc. v. Department of Revenue of State of Illinois,* 386 U.S. 753 (1967) and that physical presence is required in a state before tax collection responsibility could be imposed on a retailer. See *Quill Corp v. North Dakota,* (91-0194), 504 U.S. 298 (1992).

Amazon Bears the Burden of Battle

Nearly all other Internet retailers gladly followed Amazon's lead and refused to collect sales tax while Amazon led the fight and picked up the tab for the litigation. In the meantime, more states added pressure for Internet retailers to collect sales tax by passing laws similar to the New York law.

Rhode Island was second to pass its state law in 2009. Both Amazon and Overstock responded by cancelling their Rhode Island affiliates to avoid collecting the tax. North Carolina was next, but added a threshold sales amount of $10,000 in sales before Internet retailers had to collect and remit sales tax. Again, Amazon and Overstock retreated. By 2011 Illinois, Arkansas and Connecticut tried the North Carolina approach (Connecticut with a much lower threshold of only $2,000 in annual sales); all three states received the same retreat response by Amazon and Overstock. Vermont passed a prospective law coming into effect only after 15 other states have adopted similar laws. One can only imagine that Amazon and Overstock will exit Vermont at that time.

In some states, Amazon had a greater presence beyond maintaining contracts with marketing affiliates. In Tennessee, Amazon is building distribution centers and therefore arguably should be collecting sales tax from state residence due to the physical presence Amazon has in Tennessee. In October, 2011, Amazon agreed to begin collecting tax from shipments to Tennessee residence, but not until 2014. Amazon also had a physical presence in Texas which allowed the Texas Comptroller in 2010 to bill Amazon for the prior four years' sales tax incurred while Amazon operated warehouses in Texas. The price tag was a steep $269 million. Amazon offered to create 5,000 new warehouse jobs in Texas in exchange for a moratorium on collecting sales taxes, however in July 2011 the legislature passed a law which the governor signed requiring Internet retailers with corporate affiliates who have facilities in the state to collect sales tax.

When California joined the ranks in September, it upped the ante to apply only to Internet sellers with more than $1 million in annual sales to California addresses, who also have marketing affiliates or corporate affiliates in California. The California law was delayed for a year, until September 2012, in exchange for Amazon's promise to build warehouses in California and maintain its agreements with its California affiliates. The California law will take effect in September 2012 unless Congress passes a federal law by July 31, 2012 empowering states to require sales tax collection by the Internet merchant on-line.

Amazon to Capitalize

Amazon has suddenly apparently changed its tune and has decided that it can in fact manage the burdens of compliance with the tax laws of countless jurisdictions, and in fact it can collect and remit the sales tax for their affiliates in each state…in exchange for an additional fee of 2.9%. It turns out that Amazon had been navigating tax compliance laws for certain affiliates in every state for years (specifically the five states where Amazon has stores or offices: Kansas, Kentucky, New York, North Dakota and Washington), however now this tax collection service will be available to all affiliates and serve as a profit center for Amazon.

If this is a surprise to the states Amazon has been fighting in court, it surely is a shock to the Internet retailers who have relied on Amazon as their leader to prevent them from every having to collect and pay tax to states where the retailer had no physical presence in the strict sense of the laws regarding nexus.

It will take an act of Congress, literally, to change the standard requiring an established physical connection with each taxing jurisdiction before a retailer can be required to collect and pay over sales tax to a particular jurisdiction. However with Amazon suddenly offering to provide the tax services it has long held as too burdensome, the first of two arguments Amazon has steadfastly held to may be severely diminished leaving the nexus argument as the only argument left for smaller Internet retailers.