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SFA



BILL ANALYSIS

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House Bill 5080 (Substitute H-1 as passed by the House)
Sponsor: Representative Jason Allen
House Committee: Commerce
Senate Committee: Finance

Date Completed: 10-2-01

CONTENT

The bill would create the "Equitable Sales and Use Tax Administration Act" to do the following:

- **Allow the State to enter into a multistate streamlined sales and use tax agreement under restrictions specified in the bill.**
- **Create a board of governance that could represent the State in meeting with other states that were authorized by statute to enter into the agreement.**
- **Provide for the registration of sellers, who would have to select a method for the collection and remittance of sales and use taxes.**
- **Allow sellers to contract with certified service providers for the collection and remittance of taxes; and establish qualifications for certification as a service provider.**
- **Provide for the use of an automated system that would calculate each jurisdiction's tax on a transaction; and establish requirements for certification of an automated system.**
- **Limit the liability of a seller for taxes on transactions made before the seller's registration.**
- **Provide for consumer privacy.**
- **Require the committees responsible for reviewing tax issues in the Senate and the House of Representatives to review the revenue reports produced by the Senate and House Fiscal Agencies and consider methods to return to the taxpayers revenues from enhanced use tax compliance as a result of the bill.**

The bill specifies that at no time would its provisions create or implement a new tax on

interstate electronic commerce. Further, the bill contains the following statement:

This act is not intended to generate revenue that is not currently due under the sales and use tax acts but is intended to provide for simplification of the method of collecting the sales and use taxes that is currently authorized to be collected under those acts. Nothing in this act shall be construed to expand the tax base of the sales tax or use tax or to eliminate exemptions, but rather, this act simplifies and modernizes the sales tax and use tax administration in order to substantially reduce the burden of tax compliance for all sellers and for all types of commerce. It is the intent of the legislature that all revenues collected as a result of the implementation of this act will be distributed in the same manner as provided for revenues collected under the general sales tax act...

The bill would repeal the proposed Act effective December 31, 2002.

Agreement Requirements and Components

The bill would require the Department of Treasury, with the approval of the board of governance, to enter into the streamlined sales and use tax agreement with one or more states, "...to simplify and modernize sales and use tax administration in order to substantially reduce the burden of tax compliance for all sellers and for all types of commerce". The Department could not enter into the agreement until legislation that substantially complied with the requirements of the

agreement was enacted, and the Legislature, through resolution, expressed support for the agreement reached by the board of governance. The Department also could not enter into the agreement unless it required each signatory state (a state that had entered into the agreement) to abide by the requirements described below.

The agreement would have to do the following:

- Set restrictions to achieve more uniform state rates through limiting the number of state rates; eliminating caps on the amount of state tax due on a transaction; and eliminating thresholds on the application of state tax.
- Establish uniform standards for the sourcing of transactions to taxing jurisdictions; the administration of exempt sales; the allowances a seller could take for bad debts; and sales and use tax returns and remittances.
- Require signatory states to develop and adopt uniform definitions of sales and use tax terms. The definitions would have to enable a signatory state to preserve its ability to make policy choices that were substantially consistent with the uniform definitions.
- Provide a central electronic registration system that allowed a seller to register to collect and remit sales and use taxes for all signatory states.
- Provide that registration with the central registration system and the collection of sales and use taxes in the signatory states would not be used as a factor in determining whether the seller had nexus with a state for any tax.
- Outline any monetary allowances to be provided by the signatory states to sellers or certified service providers (described below).
- Require each signatory state to certify compliance with the terms of the agreement before joining, and to maintain compliance under the laws of the member state with all provisions of the agreement while a member.
- Require each signatory state to adopt a uniform policy for certified service providers that protected the privacy of consumers and maintained the confidentiality of tax information.
- Provide for the appointment of an advisory

council of private sector representatives and an advisory council of nonmember state representatives to consult with the signatory states in the administration of the agreement.

Further, the agreement would have to provide for reduction of the burdens of complying with local sales and use taxes through the following:

- Restricting and eliminating variances between each signatory state's tax base and the local tax bases within that state.
- Requiring signatory states to administer any sales and use taxes levied by local jurisdictions within those states so that sellers collecting and remitting the taxes would not have to register or file returns with, remit funds to, or be subject to independent audits from local taxing jurisdictions.
- Restricting the frequency of changes in local sales and use tax rates, and setting effective dates for the application of local jurisdictional boundary changes to local sales and use taxes.
- Providing notice of changes in local sales and use tax rates, and of changes in the boundaries of local taxing jurisdictions.

Any provision of the agreement or any application of a provision of the agreement to any person or circumstance that was inconsistent with Michigan law would not have effect.

Board of Governance/Department of Treasury

The bill would create a board of governance to represent this State in all meetings that were limited to only those states that also were authorized by statute to enter into a streamlined sales and use tax agreement. The board could vote on behalf of the State and represent the State's position in all matters related to the adoption or amendment of the agreement.

The board would have to report quarterly to the legislative committees responsible for reviewing tax issues on the board's progress in negotiating the agreement and recommend what State statutes were required to be amended to be substantially in compliance with the agreement.

The board would consist of the following members:

- The Majority Leader of the Senate or his or her designee who was a member or former member of the Senate or an employee of the Senate or the Senate Fiscal Agency.
- The Speaker of the House of Representatives or his or her designee who was a member or former member of the House or an employee of the House or the House Fiscal Agency.
- The Minority Leader of the Senate or his or her designee who was a member or former member of the Senate or the Senate Fiscal Agency.
- The Minority Leader of the House of Representatives or his or her designee who was a member or former member of the House or an employee of the House or the House Fiscal Agency.
- The State Treasurer or his or her designee.
- One member appointed by the State Treasurer.
- The Governor or his or her designee.
- One member appointed by the Governor.

Further, the bill would create a business advisory council to advise and make recommendations to the board. The council would consist of six members: two retail sellers domiciled in Michigan appointed by the Governor; two large national retail sellers domiciled outside the State (licensed to do business in Michigan) appointed by the Governor; and one retail seller and one manufacturer domiciled in the State appointed by the other four members.

The Department could act jointly with other signatory states to establish standards for certification of a "certified service provider" and "certified automated system" and to establish performance standards for multistate sellers. (A "certified service provider" would be an agent certified jointly by signatories to perform all of a seller's sales and use tax functions, other than the seller's obligation to remit tax on its own purchases. A "certified automated system" would be computer software certified jointly by the signatories to calculate the tax imposed by each jurisdiction on a transaction, determine the amount of tax to remit to the appropriate state, and maintain a record of the transaction.)

The Department also could take other actions reasonably required to implement the bill, including the promulgation of rules and the joint procurement of goods and services with other signatories in furtherance of the agreement. Implementation of any condition of the agreement, regardless of when implemented, would have to be by action of the State.

Seller Registration/Collection Models

A person could participate under the bill only by registering in the central registration system provided for by the agreement. The Department would have to participate with other signatory states in an online registration system that allowed sellers to register online. (A "person" would be an individual, trust, estate, fiduciary, partnership, limited liability company, limited liability partnership, corporation, or any other legal entity. A "seller" would be any person who sold, leased, or rented tangible personal property or services to another person.)

A seller registered under the agreement in Michigan would be considered registered in each of the signatory states, and a seller registered under the agreement in any other signatory state would be considered registered in Michigan. A seller could choose to register directly with other signatory states. A seller could cancel its registration under the agreement at any time, according to the agreement. A seller that canceled its registration, however, would remain liable for remitting taxes collected to the appropriate states. By registering, a seller would agree to collect and remit sales and use taxes according to the agreement for taxable sales in all signatory states, including states that adopted the agreement after the seller registered.

The bill specifies that registration of a person under the agreement and collection of sales and use taxes by that person in signatory states would not provide nexus with any signatory state, and could not be used as a factor in determining nexus with a signatory state for any tax purpose.

A registered seller would have to agree to one of the following models for purposes of collecting and remitting sales and use taxes under the agreement:

- Model 1. A seller that had contracted with a certified service provider to act as its agent to perform all of the seller's sales and use tax collection functions, other than the seller's obligation to remit sales or use tax on its own purchases.
- Model 2. A seller that had selected a certified automated system to perform part of the seller's sales and use tax collection functions, but retained responsibility for remitting the tax.
- Model 3. A seller that had sales in at least five signatory states, had total annual sales of \$500 million or more, had a proprietary system that calculated the amount of tax due in each taxing jurisdiction, and had entered into a performance agreement with the signatory states establishing a tax performance standard for the seller. (In model 3, a seller would include an affiliated group of sellers using the same proprietary system.)

In computing the amount of tax remitted to this State, a certified service provider under model 1 and a seller under model 2 could deduct a base rate that applied to taxable transactions processed through the certified automated system of the provider under model 1 or of the seller under model 2, in accordance with the terms of the contract entered into by the signatory states. A model 2 seller who took the deduction, or a seller who contracted with a certified service provider to act as its agent under model 1, could not take a deduction under Section 4 of the General Sales Tax Act (which provides for a collection allowance, that is, allows a seller to deduct and keep a percentage of sales taxes collected from purchasers). A seller under model 3 could take only the deduction allowed under Section 4.

In addition to the deduction allowed under the bill, for up to 24 months following a voluntary seller's registration, the voluntary seller also could deduct a percentage of tax generated in Michigan by the voluntary seller in accordance with the terms of the contract entered into by the signatories. (As used in this provision, "voluntary seller" would mean a seller that was not required to register to collect tax for this State.)

Liability Limitations

The bill provides that a person who registered as a seller would not be liable for any uncollected or nonremitted sales or use tax on transactions with purchasers in Michigan before the date of registration, if the seller were not licensed under the General Sales Tax Act or the Use Tax Act in the 12-month period preceding the date the State entered into the agreement. The seller also would not be responsible for any penalty or interest that could be due on those transactions. These provisions would not apply to the following:

- Any tax liability of the registered seller for transactions that were subject to sales or use tax in Michigan in which the registered seller was the purchaser.
- Any sales or use taxes already paid or remitted to the State.
- Any transactions for which the seller received notice of the commencement of an audit that was not finally resolved, including related administrative or judicial processes.

The liability limitations would apply to a seller absent the seller's fraud or intentional misrepresentation of a material fact if the seller continued to be registered and continued collection and remittance of applicable sales and use taxes in Michigan for at least 36 months. The statute of limitations applicable to assessing a tax liability would be tolled during that time.

Certified Service Provider/Automated System

The bill specifies that a certified service provider would be the agent of a seller, with which the provider had contracted for the collection and remittance of sales and use taxes. As the seller's agent, the provider would be liable for sales and use tax due each signatory state on all sales transactions it processed for the seller, except as provided in the bill. A seller that contracted with a provider would not be liable to this State for sales or use tax due on transactions processed by the provider, unless the seller made a material misrepresentation of the type of items it sold, or committed fraud. In the absence of probable cause to believe that the seller had committed fraud or made a material misrepresentation, the seller would not be subject to audit on the transactions processed

by the provider. A seller would be subject to audit for transactions not processed by the provider. The signatory states acting jointly could perform a system check of the seller and review the seller's procedures to determine if the provider's system was functioning properly, and the extent to which the seller's transactions were being processed by the provider.

The Department, acting jointly with the signatory states, could certify a person as a certified service provider if the person met all of the following requirements:

- Used a certified automated system.
- Integrated its certified automated system with the system of a seller for which the person collected tax, so that the tax due on a sale was determined at the time of the sale.
- Agreed to remit the taxes it collected at the time and in the manner specified by the signatory states.
- Agreed to file returns on behalf of the sellers for which it collected tax.
- Agreed to protect the privacy of tax information it obtained.
- Entered into a contract with the signatory states and agreed to comply with the terms of the contract.

The Department, acting jointly with the signatory states, could certify a software program as a certified automated system if the signatory states determined that the program met all of the following requirements:

- It identified the applicable state and local sales and use tax rate for a transaction based on the uniform sourcing provision established under the agreement.
- It identified whether an item was exempt from tax.
- It identified the amount of tax to be remitted for each taxpayer for a reporting period.
- It could generate reports and returns as required by the signatory states.
- It could meet any other requirement set by the signatory states.

The Department, acting jointly with the signatory states, could establish one or more sales tax performance standards for multistate sellers that met the eligibility criteria set by the signatory states and that had developed a

proprietary system to determine the amount of sales and use tax due on transactions.

A person that provided a certified automated system would be responsible for the proper functioning of that system, and would be liable to this State for underpayments of tax attributable to errors in the functioning of the system. A seller that used a system would remain responsible and liable to the State for reporting and remitting tax.

A seller that had a proprietary system for determining the amount of tax due on transactions and had signed an agreement establishing a performance standard for that system would be liable for the failure of the system to meet the performance standard.

Consumer Privacy

A certified service provider would be prohibited from retaining or disclosing a consumer's "personally identifiable information", that is, information that identified a specific person. A provider's system would have to be designed and tested to assure the privacy of consumers by protecting their anonymity.

A provider would have to give clear and conspicuous notice of its information practices to consumers, including what information it collected, how it collected the information, and whether it disclosed the information to signatory states. A provider also would have to provide the necessary technical, physical, and administrative safeguards to protect personally identifiable information from unauthorized access and disclosure.

A provider's retention or disclosure to signatory states of personally identifiable information would be limited to exemption claims because of a consumer's status or intended use of the goods or services purchased, to investigations of fraud, and to the extent necessary to ensure the reliability of the provider's technology. If personally identifiable information were retained for these purposes, in the absence of exigent circumstances, people would have to be given reasonable notification of that retention and afforded reasonable access to their own data, with a right to correct inaccurately recorded data.

This privacy policy would be subject to enforcement by signatory states' attorneys general or other appropriate authorities.

The bill specifies that the agreement would not enlarge or limit the signatory states' authority to do any of the following:

- Conduct audits or other review as provided under the agreement and state law.
- Provide records pursuant to a signatory state's freedom of information act, disclosure laws with governmental agencies, or other regulations.
- Prevent, consistent with state law, disclosures of confidential taxpayer information.
- Prevent, consistent with Federal law, disclosures or misuse of Federal return information obtained under a disclosure agreement with the Internal Revenue Service.
- Collect, disclose, disseminate, or otherwise use anonymous data for governmental purposes.

Other Provisions

The bill includes the statements described below.

Payment, collection, and remittance of the sales and use tax under the bill would be subject to the General Sales Tax Act and the Use Tax Act.

Nothing in the bill could be construed to amend or modify any State law, or to limit the authority of the Michigan Legislature.

The agreement authorized by the bill would bind and inure only to the benefit of this State and the other signatory states. No person, other than a signatory state, would be an intended beneficiary of the agreement. Any benefit to a person other than a signatory state would be established by the law of this State and the other signatory states and not by the terms of the agreement.

Nothing in the bill could be construed to limit the authority of the courts in the State. A person would have all rights and remedies provided under the revenue Act, but would not have any cause of action or defense under the agreement because of the State's approval of the agreement, or on the ground that the

Department's action or inaction was inconsistent with the agreement. (The revenue Act created the Revenue Division in the Department of Treasury and prescribes its powers and duties as the revenue collecting agency of the State.)

A law of this State, or the application of a law, could not be declared invalid as to any person or circumstance on the ground that the provision or application was inconsistent with the agreement. No provision of the agreement authorized by the bill in whole or in part would invalidate or amend any provision of State law. This State's adoption of the agreement would not modify or amend any State law.

Legislative Analyst: G. Towne

FISCAL IMPACT

The fiscal impact of this bill cannot be identified at this time. While the State currently is not collecting anywhere from \$100 million to \$300 million in sales and use taxes from taxable Internet and mail order transactions, this bill by itself would not solve this collection problem. This bill does, however, propose a major step toward possibly solving this problem. Under the bill, the State would be allowed to join a multistate agreement whose intended purpose would be to simplify and streamline the sales and use taxes among the states and to develop a uniform collection process that would not be burdensome to businesses or consumers. The scope of this potential agreement among the states, as outlined in the bill, could require Michigan eventually to make changes in its sales and use tax bases, particularly in regard to adopting uniform definitions of particular goods and services, which could have both positive and negative fiscal impacts. In addition, the State potentially would have to eliminate its current special reduction in the tax rate, from 6.0% to 4.0%, granted on residential use of electricity, natural gas, and home heating fuels. Any additional sales and use tax revenue that this bill eventually would help collect primarily would benefit the School Aid Fund, local revenue sharing, and the General Fund/General Purpose budget. About 73% of the sales tax is earmarked to the School Aid Fund and most of the remaining sales tax revenue is distributed to local governments. The use tax is distributed to

the School Aid Fund (33%) and the General Fund/General Purpose budget (67%). However, language in the bill states that it is the intent of the Legislature that all revenue collected, from both the sales and use taxes, as a result of implementing a new streamlined agreement be distributed as the sales tax is distributed.

The Department of Treasury would need to acquire the capacity for electronic acceptance of tax registration information and the electronic collection of sales and use taxes. The Department estimates this cost at \$2 million. For this purpose, \$1 million was included in both the FY 2000-01 and FY 2001-02 appropriations to the Department of Treasury.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.