Alternative Compensation Proposal
Work Group Call
2-17-10

1) Explanation of Current Alternative Compensation Proposal
   a. General Requirements
      i. Must be paid to all sellers.
      ii. Must apply to state and local sales and use taxes.
      iii. Compensation requirement will be placed in the Agreement. Compensation must be provided prior to a state getting collection authority over remote sellers. The payment of compensation is not required for Governing Board Membership.
      iv. Corresponding language will be included in federal legislation. This language must provide clear grant of collection authority for states meeting the requirements of the Agreement and assurance to retailers that states must comply with compensation requirement. Language must also allow for future <u>reductions</u> ~~adjustments~~ to compensation <u>requirement</u> as additional simplifications and improvements in technology reduce collection costs <u>or increases in the compensation requirement if provisions are adopted that increase collection costs</u>.
      v. Compensation calculation will be incorporated into the electronic return so that amount of compensation can be determined from the information included on an individual return.
      vi. A state may limit compensation only <u>for returns that are timely filed and fully paid</u> ~~to sellers that file and remit timely~~.
      vii. A state may elect to not pay compensation on a seller's purchases for their own use.
      viii. States will be allowed to restrict sellers from <u>altering the number of returns they file</u> ~~filing returns for individual locations or for related entities~~ in order to enhance their compensation.
      ix. States will not be required to pay compensation to a seller that is using a CSP (if the state is paying for the CSP service).
   b. Outline of Proposal
      i. Compensation will be paid as a percentage applied to tax remitted on an individual return. The figures in this proposal are based on a monthly return. Appropriate adjustments will be made to accommodate alternative filing periods.
      ii. Three "Tiers" of compensation are proposed to recognize that smaller sellers have much greater costs relative to the amount of tax they remit than do larger sellers. The Joint Cost of Collection Study grouped sellers into three categories. It categorized small retailers as those having annual sales of between $150,000 and $1 million, medium retailers as those having annual sales between $1 million and $10 million, and large retailers as those having annual

sales in excess of $10 million. Converting these annual sales numbers into monthly tax remitted numbers (assuming a 7.5% tax rate) results in small sellers being identified as those remitting less than $6,250/month, medium sellers as those remitting less than $62,500/month, and large sellers remitting over $62,500/month. These classifications were used to develop the proposed tiers. Under this proposal, all sellers will be paid compensation on the first $6,250 remitted each month at on rate, will be paid a lower rate on tax remitted each month between $6,250 and $62,500, and a lower rate on tax remitted each month in excess of $62,500.

iii. The rates that will be applied to Tier 1, Tier 2 and Tier 3 are proposed to be set in relation to the cost differences found in the JCCS. That study found that the cost for medium sized sellers was 40% of the cost for small sellers and that the cost for large sellers was 15% of the cost for small sellers. <u>Recognizing the impact of the proposed cap on overall compensation and that costs to retailers such as paying credit and debit card fees on the tax portion of a purchase are a larger share of the overall costs for larger sellers, it is proposed that the minimum requirement for Tier 2 compensation be 50% of that for Tier 1 and that the minimum requirement for Tier 3 be 25% of Tier 1.</u> A state can pay a higher rate for all Tiers or an individual Tier <u>as long as the minimum level of compensation is maintained for each Tier.</u>

iv. <u>Each state will determine the compensation rates for each Tier pursuant to the requirements of the Agreement. The Governing Board will determine if the proposed state rates are in compliance. Based on data from the previous year, the rates shall be set so that the total compensation that would have been paid during that year will equal .9% of total sales and use tax revenue for states without local jurisdictions and 1% for states that require sellers to report tax for local jurisdictions (allowing for exceptions specifically allowed in the Agreement).</u> ~~The compensation rates established for an individual state will be adjusted to account for the differences in the tax rates of the states. This is necessary since compensation is to be paid on the amount of tax remitted.~~

~~v. States that require sellers to report tax for local jurisdictions will pay additional compensation. It is proposed that the rates for each Tier be increased by 10%. This higher rate will apply to all sellers.~~

vi. States that have a second state rate on groceries or drugs will be required to pay additional compensation on the tax collected at that rate.

vii. Compensation will be capped by allowing states to not pay compensation on tax remitted monthly above a certain amount. For states with annual sales and use tax collections below $2 Billion the amount proposed is $1 Million/month, for states with collections between $2 Billion and $6 Billion the amount is $5

Million/month, and for states with collections above $6 Billion the amount is $10 Million/month. These amounts represent the minimum level a state can use for the upper limit on Tier 3.

viii. The states continue to work on ways to provide additional compensation to small retailers that will have a new collection obligation. Any proposal must recognize the administrative difficulty of making such payments. Discussion concerning this type of compensation must also take into account the level to be set for the small seller exception.

ix. A trigger mechanism that addresses the timing of the requirement to compensate all sellers with the receipt of new money from remote collection authority and the concern over the uncertainty of the amount of funds states may receive must be part of the proposal. The amendment that has been filed by Kansas addresses both of these concerns.

x. This compensation proposal is not applicable to other communication taxes. An appropriate provision for those taxes must be developed.

xi. An exception to the requirement to provide compensation must be allowed for transactions in which the seller is not responsible for collecting and remitting the tax.

xii. We are continuing to review the issues faced by sellers that have a large share of tax exempt sales. Any issues that can be resolved quickly can be addressed in the upcoming Governing Board meeting. Other issues can be studied further.

xiii. A provision requiring additional compensation for states with a clothing threshold will be included.