

## **Initial Business Advisory Council Compliance Subcommittee Report**

To: Compliance Review and Interpretations Committee

From: Fred Nicely, BAC Compliance Subcommittee Chair

Re: Preliminary report on 2010 Annual Recertification

Date: October 7, 2010

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First, the BAC Compliance Subcommittee would like to, again, thank Scott Peterson and Pam Cook for the excellent review work they have conducted regarding the member states' substantial compliance with each requirement of the Agreement. Any additional issues raised by this subcommittee should not be taken to diminish our appreciation for the thorough review work conducted by Scott Peterson and Pam Cook.

Second, the BAC Compliance Subcommittee understands the other member states that were not reviewed under the original report issued by Scott Peterson and Pam Cook (dated August 31, 2010) remain open for public comment. It is our understanding the other states and the public will have at least 30 days from the date that report is issued to submit comments regarding those states' compliance with the Agreement.

Next, the BAC Compliance Subcommittee believes the review by the Compliance Review and Interpretations Committee, and subsequently the Governing Board, for the member states certifying their annual substantial compliance with the Agreement as of August 1, 2010 should not be based on any rules that may be pending before the Governing Board or one of its committees.

Sec. 805 of the Agreement requires substantial compliance with each provision of the Agreement for full member states. The same standard applies for an associate member state seeking compliance under Sec. 310.1 of the Agreement, except that compliance is based on the sourcing requirements specified in Sec. 310.1 rather than just Sec. 310. For an associate member state claiming it meets the membership requirements solely under Sec. 801.3 of the Agreement, the substantial compliance review is with the Agreement as a whole, which includes the state showing it meets the minimum requirements promulgated in Rule 801.1.

The analysis to determine substantial compliance must be based on a qualitative review to determine the "total effect" of a state's laws, rules, regulations and written policies. This must also include a review of the taxing agency's practices and procedures to verify a state complies with all the requirements of the Agreement. This applies regardless of whether the compliance issue was an item listed on the Certificate of Compliance; however, it is understood the imposition of any sanctions would take the lack of notice of an item on the Certificate of Compliance in consideration.

Addressing a state trying to prove a negative (situations that a state would not necessarily need a law or regulation), *e.g.*, the state does not have a cap or threshold, a state simply asserting (correctly) it has no such provision is sufficient. However, a provision of the Agreement that requires a state to provide specific relief to a seller, CSP or purchaser (as applicable) must clearly

have those provisions incorporated in its law, rules or regulations (or, potentially, a temporary written policy until a law or regulation can be put in place). A member state merely checking a box on a Certificate of Compliance without providing an authoritative cite to a law, rule, regulation, or independent written policy from the Certificate is not sufficient to protect sellers, CSPs and purchasers.

Lastly, the BAC has incorporated all the issues raised by Scott Peterson and Pam Cook in the BAC Compliance Subcommittee's comments. Any new comments are underlined at the end of each state that was reviewed.

### Arkansas

There is no provision for relief for liability if a state rate change takes effect in less than 30 days.

The rule providing for use of a blanket exemption certificate only applies to resellers. The Agreement provision does not appear to limit the use of blanket certificates to resellers.

The definition of "sales price" does not contain the provisions related to consideration received from third parties which is in the Agreement definition.

### Iowa

~~There is no provision for relief from liability if a state has a rate change take effect in less than 30 days.~~ **BAC believes Iowa complies pursuant to Section 423.46 of Iowa's Code.**

It appears that the base for the local tax is slightly different from the state base. Sales of tangible personal property by the Department of Transportation are excluded from the local base, but a similar exclusion or exemption was not found for the state base.

Rule 701-18.20(7)(d)(3) includes one-way paging as a non-taxable service. The definition of paging includes one-way and two way paging. The Governing Board in their August, 2010 meeting adopted the position that all paging must be taxed or exempted.

### Kansas

The statute authorizes an additional 2% state tax in special redevelopment districts.

### Kentucky

There is no provision for relief from liability if a state has a rate change take effect in less than 30 days.

The statute cited for the relief from liability provided to sellers and CSPs for errors in the taxability matrix (Section 328 of the SSUTA) is the one providing relief for reliance on previous certified software. There is no provision that provides the Section 328 relief.

The state exempts "rate increases" for the school tax and any other taxes and surcharges relating to telecommunications service. The school tax and many of the other charges are imposed on the provider of the service and the definition of sales price includes them. Sales price only excludes such charges if they are imposed directly on the consumer. This issue is carried over from the

2009 review and has been referred to the State and Local Advisory Council (SLAC) where it is under review.

**Contrary to Rule 317 of the SSUTA, the tax agency has indicated that it will require a seller accepting a non-SSUTA exemption certificate form to be held to a higher standard than that allowed by a seller using the SSUTA's form. Website has multiple exemption forms some requiring more than that required by the SSUTA.**

**Section 139.270(2)(c)2 – Contains a provision requiring the exemption be available in the state; however, the provision is not limited to over-the-counter sales.**

### **Minnesota**

The taxability matrix indicates that digital audio works are not taxable in general but that ringtones are. Digital audio works is a product definition that includes ringtones. Ringtones is defined “for purposes of the definition of “digital audio works”” and is not set out as a separate definition that can be treated as a product definition. This issue was identified in the 2009 review process. No change was made in the 2010 legislative session.

The SSUTA bad debt provisions provide that when the amount of bad debt written off is greater than the taxable sales for the period, a refund claim may be filed. The state instead allows the excess to be used in the subsequent month. While this may be same as a refund for some at certain times, but not if the amount is so large it exceeds taxable sales in the subsequent month.

The rounding rule in the statute cited does not require computation to the third decimal place.

The definition of “sales price” does not include the receipt of consideration from third parties provisions.

For a number of items, the state uses administrative practice for the legal authority. These include the Section 317 provision for drop shipments, the Section 324 provision allowing sellers to round at the item or invoice level, the Section 329 effective date for services covering periods before and after the effective date of the change, and the Section 401 provision that the state will not use registration under the central system in determining whether a seller has nexus.

### **Nebraska**

By regulation, mailing lists delivered electronically are taxed as tangible personal property.

**Unclear if regulation (1-013.03) regarding exemption certificates requires more information than allowed pursuant to Section 317 of SSUTA (and its rule). Has it been superseded by another regulation?**

### **Nevada**

The definition of sales price excludes certain federal excise taxes whether imposed on the seller or purchaser. This issue was referred to SLAC as a result of the 2009 review process and is still under review.

The definition of sales price includes certain delivery charges and installation in “services necessary to complete the sale.” The SSUTA definition specifically excludes them from this category.

Their definition of “receipt” is taking possession or making first use of tangible personal property. In the SSUTA it is taking possession of tangible personal property, making first use of services, or taking possession of or making first use of digital goods.

The bad debt statute says that collections of amounts previously claimed as a bad debt are to be applied first to the taxable price of property or services and to sales tax, and secondly to other charges such as interest. The SSUTA states that the amount should be applied “proportionately” to the sales price and tax.

The provision for drop shipments requires that the resale certificate be taken in good faith. The SSUTA does not include a good faith requirement.

The statute exempts certain “medical devices,” which according to their taxability matrix includes mobility enhancing equipment and durable medical equipment. “Medical devices” is not a term in the SSUTA and the statute and administrative code do not define it.

The state has been declared out of compliance by the Governing Board because it has not fully implemented ACH credit payments. The state is in the process of completing the full implementation of ACH credit.

**SSUTA exemption certificate (or equivalent) was not found on tax agency’s website.**

### **North Carolina**

No 30 day rule for rate changes, but did comment that provided relief in this situation in 2009.

There appear to be a number of differences in the state and local tax bases. Electricity and certain digital products are subject to state tax but not local tax. Two of the local sales taxes exempt bundled transactions which are taxed at the state level and under other local taxes.

The statute defines prepaid telephone calling service to include prepaid wireline calling service and prepaid wireless calling service. There is no definition for prepaid calling service (which includes both wireline and wireless service) and prepaid wireline calling service is not a defined term. This was noted in last year’s review and legislation was requested, but did not pass. There is not an effect under today’s offerings by the industry.

The definition of “postpaid calling service” does not exclude prepaid wireless calling service.

The sourcing statute puts the option of using the mobile phone number with the fourth step (address of the payment instrument) instead of the fifth (ship from, service performed).

The definition of “receive” and “receipt” does not have the words “or taking possession or making first use of digital goods”. Several types of digital goods are taxed in the state.

The sourcing for mobile telecommunications service excludes prepaid wireless calling service. The SSUTA excludes prepaid calling service (which is mainly wireline) and not prepaid wireless calling service.

The sourcing for private communications does not follow the SSUTA with respect to segments that are not billed separately.

The definition of “service address” is not complete. It includes the first step but not the second (origination of the signal) or third (place of primary use).

The bad debt technical bulletin allocates amounts collected that were previously reported as bad debt proportionately first to sales price and secondly to interest and other charges. It should be proportionately to sales price “and sales tax thereon.”

The effective date language in the statute for services covering periods before and after the statutory effective date contains the sentence: “For a service billed before it is provided, the first billing period starts on the first day of the month after the effective date.” The Agreement provides that the change is effective on the first billing period on or after the statutory effective date. The first billing period could be any day of the month.

The technical bulletin on bundled transactions provides that transactions with “10% or more” taxable property are taxable. This should be “more than 10%.”

The statute cited for providing relief from liability from errors in the taxability matrix for sellers and certified service providers (Section 328) and purchasers (Section 331) only relates to errors in information on rates, boundaries and taxing jurisdiction assignments. There is no provision for errors in the taxability matrix.

### **Rhode Island**

The taxability matrix indicates that international, interstate and intrastate 900 services are exempt. These are telecommunications services and all telecommunications services appear to be taxable in the state. No exemption for 900 service was found in the statute. This is not a charge for the information or other service provided by the customer of the telecommunications provider.

The statutes cited under Section 331 for purchasers’ relief from liability only apply to sellers and certified service providers.

The statute cited for relief from liability if a change goes into effect in less than 30 days does not contain that provision. It does contain the other Section 304 provisions.

### **South Dakota**

There is no provision to require amounts collected that previously were reported as bad debt be allocated proportionately first to taxable price and sale tax thereon and then to other charges.

### **Tennessee**

There is no provision for relief for liability if a state rate change takes effect in less than 30 days. The state administratively has provided some relief in the past.

The definition of “sales price” includes bundling language. Bundling language was specifically taken out of the SSUTA definition.

No provision allowing 90 days after the sale to obtain an exemption certificate or for 120 after request by the state to prove the exemption is valid.

The statute cited for purchasers’ relief from liability for errors in the taxability matrix is the one for sellers and certified service providers and provides such relief for dealers. It does not appear to include purchasers.

Unable to determine if the state has adopted a written policy was provided for the effective date requirements in Section 329.

**Tennessee does not comply with either section 310 or section 310.1 of the SSUTA until July, 2011. A state should be required to comply with one of those essential sourcing provisions to retain associate member status.**

### **Washington**

No issues.

**Concern with instate sellers ability to use SSUTA exemption certificate in all circumstances.**

### **West Virginia**

The state does not tax specified digital products, but has “yes” in the boxes for D1-4 and G of their taxability matrix.

The taxability matrix indicates that conference bridging service is taxable. No other ancillary service is taxable and the statutes do not appear to address it.