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States Should Adopt a Version of Colorado's Remote Sales Tax Law

By Michael Mazerov

States lose billions of dollars each year because many people and businesses that purchase items on the Internet or through catalogs aren't aware of or ignore the fact that they owe sales tax even if the merchant doesn't charge it. By adopting a version of a law enacted in Colorado that requires the seller to remind customers of their payment obligations, states can increase the revenue available for public services and level the playing field on which in-state and out-of-state sellers compete.

The Supreme Court has held that a state can't require an out-of-state retailer to charge sales tax to its residents unless the seller has a facility, employees, or some other kind of physical presence in the state. Nonetheless, if someone buys something online or from a catalog that would be subject to sales tax if she bought it in a local store, she's legally obligated in every state to pay the tax directly to her state revenue department if the seller doesn't include tax in the bill. Many people still don't know this, however, and most of those who do ignore the law. That's unfortunate, because states' inability to collect all sales taxes due on Internet, catalog, and other remote sales impedes their ability to fund education, health care, and other critical building blocks of thriving communities and strong economies. It also puts local merchants who must charge sales tax at a significant pricing disadvantage in competing with remote sellers that don't have to, reducing their sales and further harming local job creation.

To address these problems, state and local officials have long sought enactment of a federal law reversing the Supreme Court decision and empowering them to require large remote sellers to charge applicable sales taxes *regardless* of whether they're physically present in a state. Although such a bill passed the U.S. Senate in 2013, no further congressional action seems imminent.

In the absence of a federal solution, Colorado enacted an innovative law that requires remote sellers that don't charge sales taxes to inform their customers that they likely still owe them. The law also requires remote sellers to report some customer purchase information to the state's department of revenue so that it can take steps to collect the tax directly from buyers when it decides it is cost-effective to do so. Specifically, Colorado's law requires remote sellers that don't collect applicable sales taxes to do three things:

- Inform the buyer each time she makes a purchase that she may owe tax despite its not being charged;
- Annually mail a document to Colorado customers reminding them that they likely owe tax on some of their purchases *and* compiling their total annual purchases from the retailer to help them calculate what they owe; and
- Annually furnish a report to the Department of Revenue identifying all Colorado customers and the total dollar amount of merchandise they purchased (but *no* information about the nature of the purchases).

Colorado's 2010 law was tied up in court for almost seven years, but all legal challenges were settled in February 2017. The law took effect on July 1, 2017. The Colorado Department of Revenue has also drafted a regulation that provides more detail to remote sellers about how to implement the law's three key requirements and relaxing some provisions to facilitate compliance. For example, the regulation exempts remote sellers with less than \$100,000 in annual Colorado sales from the law.

A committee of the Multistate Tax Commission (MTC), an interstate compact to which Colorado and many other states belong, has developed a refined version of Colorado's law that combines provisions of the law and the regulation into a single bill that is intended to be a model for states that wish to adopt such a law. Although the proposal has not yet gone through the Commission's formal model law approval process, it has been carefully considered and fine-tuned by the committee's legal, auditing, and tax policy experts from numerous states.

The MTC draft improves on Colorado's law in some important respects. For example, it includes explicit language declaring that the annual purchase statement that goes to the state revenue department is subject to the same taxpayer confidentiality standards (and penalties for violating them) as any other tax document.

With the legality of Colorado's disclosure and reporting law now effectively established, all 45 states levying sales taxes should adopt a version of it as soon as possible.¹ Ideally, states will enact the current MTC model. It is vital that states adopt all three notification and reporting provisions in the Colorado law. In particular, the customer purchase information that sellers provide annually to the revenue department gives the law more clout by putting buyers on notice that they could, at least in theory, be subject to some enforcement action by the state. States should also take steps to make it as easy as possible for buyers to pay the taxes directly to their departments of revenue. For example, they should set up a single web page to provide all necessary information

¹ Seven states have enacted some version of a sales tax notification and reporting law. For reasons discussed in the second text box below, most of them are inferior to both Colorado's law and the MTC draft.

and allow buyers to calculate tax on small-dollar purchases using an income-based lookup table rather than having to identify and total actual past purchases.²

Because of their obligation to collect sales taxes on behalf of states in which they are physically present, the order forms of catalog companies have long included statements like “Residents of New York and California, add applicable sales tax.” Such statements have had the effect of misleading consumers into believing that no sales tax is owed if they do not reside in one of the listed states. The same miseducation occurs every time an Internet invoice shows a zero amount on the sales tax line because the seller is not required to collect the tax. This misinformation has increased the sales of these companies by making their prices look lower than they are. It is thus entirely appropriate that remote sellers be required to proactively inform their customers that they likely owe tax even when the seller isn’t collecting it. State adoption of Colorado’s law will encourage at least some additional consumers to remit the taxes they owe on their Internet and catalog purchases. It will also provide state revenue departments with information they can use to seek directly from buyers payment of unpaid tax on “big-ticket” items.

Widespread adoption of Colorado’s law could also spur the enactment of federal legislation that would grant states the power to require sellers that aren’t physically present to charge sales tax. This legislation has stalled in Congress in no small part because many Internet and catalog customers don’t understand their current tax payment obligations, which has enabled anti-tax forces to falsely characterize the federal legislation as imposing new taxes. Federal legislation remains the best and most comprehensive means of ensuring that states and localities receive the sales taxes that are due and that all retailers compete on a level playing field. But until it is enacted, states are justified in using every tool the courts have granted them to collect the sales tax due on remote sales and protect their local businesses from unfair competition.

Sales and Use Taxes: What Are They, Who Pays Them, and When?

Forty-five states and thousands of local governments levy sales taxes on in-state purchases of goods and (to a lesser extent) services.³ Sales taxes are a critical source of financing for education, health care, public safety, parks, economic development, and a host of other important state and local services that provide a high quality of life to citizens, undergird thriving local economies, and help people improve their standard of living. Sales taxes supplied 31 percent of all state tax revenue and 12 percent of local tax revenue in 2014.⁴

Sellers add applicable sales taxes to the purchase price, collect the taxes from the buyer at the time of sale, and periodically remit the taxes collected to the revenue department of the state in

² To minimize compliance costs for remote sellers, neither the Colorado law nor the MTC model requires them to identify whether purchases reported on the annual report to buyers are actually taxable. They may not be; for example, they could be food items, which are tax-exempt in most states. Thus, while buyers could choose to pay tax on the exact amount of purchases reported to them on the annual form, many would want to review their actual purchases in more detail to determine how much tax is owed. A lookup table would take into account the average amount of taxable purchases and thus obviate the need to do so.

³ Hereafter in this report, explicit references to local government sales taxes will generally be dropped in the interest of readability. Nonetheless, essentially all the discussion in this report is relevant to local sales taxes as well.

⁴ Governments Division, U.S. Census Bureau, <https://www.census.gov/govs/local/>.

which the sale occurred. Sales taxes are due on a large share of purchases made by individual consumers, although some items, such as groceries, are exempt in many states. Sales taxes also often apply to certain purchases made by businesses, such as furniture, computers, and office supplies.

From the time that sales taxes were first enacted in the 1930s, lawmakers understood that the tax would fall short of its full revenue-generating potential and disadvantage in-state merchants if households and businesses could buy taxable items from out-of-state sellers that did not charge the tax. States could not legally apply sales taxes to out-of-state purchases, however, since the “sale” — the payment to the purchaser and the transfer of possession of the item — did not occur in the state. But the courts soon upheld the states’ authority to impose taxes equal in magnitude to the sales tax on these purchases when the items were delivered (or brought by the buyer) into the state for “storage, use, or other consumption.” Now, every state that imposes a sales tax imposes a “use tax” on items subject to sales tax. In other words, in virtually all cases, a product that is subject to state sales tax if purchased in a local store is subject to use tax at the same rate if purchased from a remote seller.⁵

A major problem remains, however. While the levying of use taxes is entirely legal, the U.S. Supreme Court ruled in 1967 — and reaffirmed in its 1992 *Quill* decision — that a state cannot require an out-of-state seller to collect and remit the state’s use tax unless the seller has some type of physical presence (for example, property or employees) in the state. The basis of both decisions was the Court’s belief that the diversity of sales and use tax rates, exemptions, and administrative rules among the states created an unreasonable burden on remote sellers’ conduct of interstate commerce in violation of the Constitution’s Commerce Clause. The Court concluded that the clearest way to protect remote sellers from those burdens was to immunize them from use tax collection in states in which they lacked a physical presence.

The decreasing cost of interstate transportation and communication and, especially, the post-*Quill* advent of the Internet, have enabled even quite small firms to operate a profitable interstate retailing business with no need for a physical presence in more than a handful of states.⁶ Remote selling — now largely synonymous with Internet selling — has exploded in the 25 years since the *Quill* decision.

Lacking the authority to require non-physically-present sellers to collect and remit use taxes, states and localities have experienced exploding revenue losses; the annual revenue loss attributable to online commerce alone has been estimated at more than \$10 billion.⁷ While purchasers are legally obligated to report and remit use taxes on taxable purchases, it is difficult and costly for states to obtain compliance — in part because many buyers are still ignorant of those obligations. The physical presence standard has also substantially nullified the primary goal of use taxes — ensuring

⁵ The same is not true with respect to purchases of taxable services; use taxes usually are not assessed under state law (although there is nothing barring their imposition). Some local governments do not levy local use taxes on some or all remote sales of goods and services to which local sales taxes apply.

⁶ The Internet made possible the creation of easily updatable online “catalogs” listing millions more items than could be included in even the largest print catalog.

⁷ Donald Bruce, William F. Fox, and LeAnn Luna, “State and Local Government Sales Tax Revenue Losses from Electronic Commerce,” April 13, 2009; <http://cber.utk.edu/ecom/ecom0409.pdf>.

that local merchants obligated to charge sales taxes compete on a level playing field with remote sellers that are not. Local businesses in many retail industry segments have suffered deep sales losses due to “tax-free” competition, and for many those lost sales have represented the difference between survival and failure.

Colorado’s Sales Tax Notification and Reporting Law

States have pursued four principal strategies in response to the growing revenue losses and local merchant hardships resulting from their inability to require many remote sellers to charge use taxes. Two involve repealing *Quill* outright through litigation or federal legislation, and the third aims to narrow the application of the decision by expanding the concept of “physical presence.” (See the first box below, “State Responses to the Problem of Untaxed Remote Sales,” for more details.)

State Responses to the Problem of Untaxed Remote Sales

States have pursued four principal strategies in response to the growing revenue losses and local merchant hardships that result from their inability to require many remote sellers to charge sales and use taxes.

States have sought federal legislation that would effectively overturn the *Quill* decision. The Court made clear in *Quill* that Congress has full authority to modify or eliminate the physical presence requirement for mandatory tax collection. State representatives have acknowledged that achieving some degree of improved interstate harmonization and simplification of sales tax laws is a political precondition of enacting federal legislation to reverse *Quill*. In 2000, state representatives initiated development of the Streamlined Sales and Use Tax Agreement, a set of model sales tax definitions and simplified administrative procedures. Currently, 23 states have incorporated the provisions of the Streamlined Agreement into their sales tax laws. Legislation has been introduced in every recent session of Congress empowering states that have adopted the Streamlined Agreement (or simplified their sales taxes in similar ways) to require all large remote sellers to collect their sales taxes, regardless of whether they are physically present in the state. The Senate approved this “Marketplace Fairness Act” in May 2013, but the House has never even held a hearing on the bill. No further congressional action seems imminent.

State representatives have sought to clarify and expand the definition of what constitutes a physical presence in a state to compel more remote sellers to charge sales tax. The most well-known example of this strategy is New York’s 2008 “Amazon law” — since adopted in some 20 states — requiring remote sellers with members of their “affiliate programs” in the state to charge sales tax.*

Several states have enacted laws that require remote sellers to collect and remit sales taxes if they have more than a minimal amount of sales in the state, even if they lack a physical presence. While the primary goal of these laws is to bring a new case to the Supreme Court in the hope that it will reverse *Quill*, some companies reportedly have decided to comply and collect tax. South Dakota’s efforts have received the most attention, and it appears to be furthest along in moving a case to the Court.

States have taken steps to try to collect more sales tax from *buyers*. For example, an increasing number of state revenue departments are issuing reminders to taxpayers close to the April income tax filing deadline that they must pay their sales taxes at the same time. Many have recently added a sales tax remittance line to their income tax returns to make compliance easier or started providing information about the tax in their income tax booklets.

*An “affiliate” is an independent website that displays banner advertisements and may engage in other marketing activities on behalf of an out-of-state retailer. When someone clicks on the banner ad they are switched to the retailer’s website. If they then make a purchase, the affiliate is paid a sales commission based on the size of the purchase. See: Michael Mazerov, “New York’s ‘Amazon Law’: An Important Tool for Collecting Taxes Owed on Internet Purchases,” Center on Budget and Policy Priorities, July 23, 2009.

The fourth strategy seeks increased compliance by *purchasers* with their use tax self-remittance obligations. (Note: from this point forward, in keeping with everyday usage, this report will

generally use the term “sales tax” when, technically, collection or self-remittance of use tax is being discussed.) The activities states have pursued under this strategy range from public education, to gentle nudging, to more forceful enforcement.⁸

In 2010 Colorado enacted an innovative law aimed at educating purchasers about their obligation to self-remit unpaid sales tax and providing information to the state revenue department that would facilitate its collecting sales taxes.⁹ The law was drafted in a rather bare-bones fashion that left many important implementation details unspecified, but the Colorado Department of Revenue has issued a regulation that fills in many of these details.¹⁰ Taken together, the law and the regulation impose the following three requirements on remote sellers that, because of the *Quill* decision, are not obligated to collect Colorado sales or use taxes (and choose not to collect these taxes voluntarily):

- **Non-collecting remote sellers must notify their Colorado customers at each purchase that they may owe sales tax on what they bought, notwithstanding that the seller did not charge them for the tax.** This notification would most commonly take the form of a text box on the purchase summary that would appear on the buyer’s computer screen prior to executing the purchase.
- **Non-collecting remote sellers must mail a statement to their Colorado customers by January 31 each year including the same notification of their possible self-remittance obligations that is mandated at each purchase and summarizing the dollar amounts and nature of their purchases in the previous year.**¹¹ The purchase information must break down the total purchase amount into such categories as books, consumer electronics, and food to facilitate taxpayer compliance with sales tax self-remittance obligations.¹² The envelope must state “important tax document enclosed” to increase the chance that it will be opened and read. Finally, the document must state that information concerning the customer’s total annual purchases, but not the nature of those purchases, is also being provided to the Colorado Department of Revenue.

⁸ Despite enormous press attention to the issue of Internet sales taxation in recent years, a 2015 poll found that 38 percent of Americans remained unaware that they must self-remit taxes on online purchases if they are not charged the tax. (International Council of Shopping Centers, “ISCS 2015 National Efairness Poll Results,” <http://www.streamlinedsalestax.org/uploads/downloads/National%20Efairness%20Poll%20Results%20101915%20FINAL.PDF>.) Similarly, a 2011 survey conducted by George Runner, a member of the California Board of Equalization (the agency that administers that state’s sales tax), found that 35 percent of Californians who actually shopped from catalogs or online were unaware of this obligation. (The survey is summarized in Geoffrey Propheter, “Use Tax Awareness and Compliance: A Survey Analysis,” State Tax Notes, July 23, 2012. The 35 percent figure is the author’s tabulation of the raw survey data provided by Mr. Propheter.)

⁹ House Bill 10-1193, enacted February 24, 2010, codified at Section 39-21-112, Colorado Revised Statutes, http://www.leg.state.co.us/clics/clics2010a/csl.nsf/fsbillcont/B30F574193882B4B872576A80026BE0C?Open&file=1193_enr.pdf.

¹⁰ Colorado Rule 39-21-112(3.5), <https://www.colorado.gov/pacific/sites/default/files/39-21-112%283.5%29%20emergency%20final.pdf>.

¹¹ The regulation also allows customers to affirmatively “opt in” to receive the statement by email or another electronic medium.

¹² The regulation states that this breakdown must be provided “if available.” It is difficult to imagine a circumstance in which it would not be available.

- **Non-collecting remote sellers must report to the Colorado Department of Revenue by March 1 each year the total annual purchases (in dollars) of each of their Colorado customers, but no information concerning the nature of those purchases.** The information to be furnished includes the name, billing address, and shipping address of each customer. In virtually all cases this information must be filed electronically.

The regulation includes several provisions intended to relax requirements in the law and mitigate compliance costs. Most importantly, the regulation exempts remote sellers with less than \$100,000 in annual Colorado sales from all three of the law's requirements. Further, the annual statements to buyers and the revenue department are not required if the seller determines that all the items sold are tax-exempt. Finally, the regulation provides maximum penalties for non-compliance that were not included in the law itself.

The Data and Marketing Association (DMA), a trade association representing catalog and online retailers, immediately challenged the legality of the Colorado law on several grounds. Most importantly, it argued that the law discriminated against interstate commerce in violation of the Commerce Clause of the U.S. Constitution since it arguably only applied to out-of-state companies. A federal court granted an injunction against the law's enforcement. The legal challenges went all the way to the U.S. Supreme Court twice (once on a procedural issue), but in December 2016 the Court declined to overturn a lower court decision that the law did *not* discriminate against interstate commerce. The DMA settled all potential legal challenges in February 2017, and the law took effect on July 1, 2017. Although in theory challenges to similar laws other states enact in the future could still be mounted, this is highly unlikely given the substantial resources DMA devoted to this litigation over nearly seven years.

Multistate Tax Commission's Refinement of Colorado's Law

The Multistate Tax Commission (MTC) is the operating arm of an interstate compact to which Colorado and 15 other states belong. (Nearly all states participate in the Commission's activities to some extent.) One of the Commission's primary goals is to encourage greater uniformity among the states in how they tax corporations doing business in multiple states and transactions that cross state lines. Its Uniformity Committee, composed of policy, legal, and compliance staff of state revenue departments, develops model regulations and laws that are submitted to the full Commission, which in turn may formally recommend them to states for adoption.

Shortly after the introduction of the Colorado law, the MTC initiated a project to develop a version of it for recommendation as a model to states that wished to impose sales tax notification and reporting requirements. The Uniformity Committee finished its work on the model in early 2012, but the MTC did not undertake the formal adoption process pending resolution of the legal challenges to the Colorado law.

The draft model combines the provisions of the Colorado law and regulations, streamlines them, and improves upon them in several key respects. For example, the MTC model:

- Omits the requirement in the Colorado law that the annual notice mailed to purchasers be sent by first-class mail, allowing less expensive mailing options to be used.

- Mandates that the annual statement to purchasers include instructions about how they can obtain information from the state revenue department about how to comply with their self-remittance obligations. (Providing such instructions is optional in the Colorado regulation.)
- Explicitly states that the customer purchase information furnished to the revenue department is subject to the same confidentiality rules as all other taxpayer information, including penalties for unauthorized disclosure.
- Omits an ill-advised provision of the Colorado regulation that exempts sellers from providing annual statements to the purchaser if the seller made less than \$500 in annual sales to the buyer in the previous year.¹³ This provision potentially would allow purchasers making thousands of dollars' worth of purchases to avoid being reminded of their self-remittance obligations close to the time the payments are due if they bought from multiple sellers in less than \$500 increments. Moreover, they could be blindsided by state enforcement action against them since remote sellers are still required to furnish information about their purchases to the state revenue department. While the goal of this Colorado provision is reasonable — avoiding imposing unnecessary costs on sellers when their customers make minimal purchases — the MTC model has already taken a step in this direction by eliminating the requirement for first-class mailing.

The MTC is currently studying whether to make additional changes to its version of the Colorado law (it also incorporates the Colorado regulation). For example, it is studying how to impose the reporting requirements on online marketplaces — websites that list merchandise for sale by independent retailers, present the buyer with an invoice, and, sometimes, bill the buyer's credit card.

Why All States Levying Sales Taxes Should Enact the MTC Model

The MTC version not only is substantively superior to the Colorado law in several respects, but it is more likely to be adopted by a significant number of states because MTC deliberately developed it as a model for all states to consider. Interstate uniformity will reduce the compliance costs of remote sellers that are subject to sales tax notification and reporting requirements in numerous states. Notwithstanding that some further refinements may be in the offing, all states with sales taxes should enact the current MTC version of the Colorado law as soon as possible for the following reasons:

- **Remote sellers should be required to correct the misinformation about buyers' sales tax self-remittance obligations that they effectively have been spreading for many years and from which they have benefitted.**

Because of their obligation to collect sales taxes on behalf of states in which they are physically present, the order forms of catalog companies have long included statements like "Residents of New York and California, add applicable sales tax." Such statements have had the effect of misleading consumers into believing that no sales tax is owed if they do not

¹³ Vermont's sales tax notification and reporting law contains the same provision.

reside in one of the listed states. The same miseducation occurs every time an Internet invoice shows a zero amount on the sales tax line because the seller is not required to collect the tax. At least one-third of online and catalog shoppers remain unaware that they are legally obligated to self-remit sales tax on taxable items if the seller doesn't charge it.¹⁴ This misinformation has generated additional sales for these companies by making their prices look lower than they are. It is thus entirely appropriate that remote sellers now be required — at each purchase and again in an annual report — to proactively inform their customers that they likely owe tax even though the seller isn't collecting it. This additional consumer education will encourage at least some additional consumers to remit the taxes they owe on their Internet and catalog purchases.

- **Like other kinds of third-party reporting of tax information, the annual retailer reports of customer purchases to state revenue departments will likely encourage some additional buyers to comply with their sales tax self-remittance obligations.**

Reporting of pertinent information by third parties to tax agencies is a standard and essential element of tax enforcement. A highly relevant example and one that is familiar to many taxpayers is the federal Form 1099 that banks and mutual funds provide to both their customers and to the IRS listing the customers' interest and dividend income in the preceding tax year. As with self-remittance of sales taxes, the income tax payment obligation falls on the recipient of the interest and dividend income, but the law obligates a third party with information about the income to provide it to both the taxpayer and the tax agency.¹⁵

The annual retailer report to the state department of revenue of total customer purchases can be thought of as a "Form 1099-Sales Tax." Just as an actual Form 1099 explicitly states that the information on it is being shared with the IRS, the annual customer purchase form must state that the information is also being shared with the state tax agency. And just as taxpayer knowledge that such sharing occurs encourages the taxpayer to report the income, taxpayer knowledge that the total purchase amount is being shared is likely to encourage at least some buyers to comply with their sales tax self-remittance obligations.

In the interest of preserving consumer privacy, the Colorado law requires that information about the nature of the items purchased is *not* reported to the state revenue agency. As such, state agencies lack information they need to determine conclusively the precise amount of tax owed on the purchases reported by sellers. States are unlikely to invest in the computer software and hardware that would be needed to automatically match all the purchase information that sellers report with what buyers report since some discrepancies between the purchase information reported by sellers and the taxes paid by buyers could only be resolved using information not directly available to state revenue agencies on the forms.

¹⁴ See Note 8.

¹⁵ In the case of wage and salary income, the law goes further and requires an employer not only to report the income to the IRS on a W2 form, but also to withhold tax from the employee's paycheck and remit it to the agency. Of course, that is precisely what the *Quill* decision's physical presence test bars with respect to sales and use taxes.

Nonetheless, the fact that, in theory, the revenue agency *could* use the information on the form to seek payment of non-remitted tax from the buyer gives the law more clout without which it is unlikely to have a significant impact on buyer compliance. As noted above, roughly two-thirds of online shoppers *do* seem to be aware that they are obligated to self-remit tax but only a tiny share comply because they are aware that state tax agencies have no knowledge of their purchases.¹⁶ It is thus essential that the provision mandating an annual report to the revenue department be preserved when states enact the law. Unfortunately, several states have enacted versions of the Colorado law that omitted this provision. (See the text box below, “Which States Have Enacted Laws Similar to Colorado’s?”) The Appendix explains why the consumer privacy issues that have been raised to justify omission of this provision have been grossly exaggerated.

- **The customer purchase information provided to the state revenue department will enable it to engage in targeted efforts to collect sales taxes from buyers when it determines it is cost-effective to do so.**

Although states will not use the customer purchase information to collect sales taxes from every person or business that owes them, they likely *will* use it selectively. If a particular household makes sufficiently large aggregate purchases, it could well be cost-effective for a revenue department to contact the household to request documentation that the purchases were not subject to sales tax and then bill them for the tax if they don’t provide documentation. If an in-state business made the purchases, it might even be cost-effective for the department to conduct an on-site audit. Both cases will generate some amount of additional sales tax revenue. In addition, the customer information will provide the department with a more accurate picture of the extent of non-compliance and help it assess whether additional public education or other enforcement efforts on its part are warranted and where it can best allocate limited resources.

¹⁶ Nina Manzi, “Use Tax Collection on Income Tax Returns in Other States,” Research Department, Minnesota House of Representatives,” April 2015, p. 7, <http://www.house.leg.state.mn.us/hrd/pubs/usetax.pdf>.

Which States Have Enacted Laws Similar to Colorado's?

In addition to Colorado, the seven states in the table below have enacted some type of sales tax notification and reporting law. Two — Louisiana and Washington — have enacted all three provisions of the Colorado law, but Louisiana's law remains seriously flawed because there are no penalties for non-compliance. Alabama's law delegates to the state revenue department complete authority to implement all three requirements and impose penalties, but no action has yet been taken. The other four states only require one or both of the *buyer* notifications in the Colorado law, and in three there are no penalties for non-compliance. Some of the laws are ambiguous about how often and where the notifications are to be presented. Others allow the notifications to be provided by email, which is likely to be ignored. In short, most of the other states' laws are inferior to Colorado's, which is itself inferior to the Multistate Tax Commission's draft model law.

State	Law effective	Law codified beginning at	Each-purchase notification?	Annual notification?	Annual report to revenue department?	Non-compliance penalties?
Alabama	7/1/17	40-2-11(7)(b)	Likely yes*	Likely yes*	Likely yes*	Likely yes*
Kentucky	7/1/13	139.450	Yes	No	No	No
Louisiana	7/1/17	47.309.1	Yes	Yes	Yes	No
Oklahoma	11/1/16	68-1406.1	Yes	Yes	No	No
South Dakota	2011	10-63-1	Yes	No	No	No
Vermont	7/1/17	32.9712	Yes	Yes	No	Yes
Washington	1/1/18	82-08-052	Yes	Yes	Yes	Yes

*All drafting details were delegated to the Alabama Department of Revenue, which has yet to act.

- **Widespread adoption of the notice and reporting law could spur the enactment of federal legislation reversing the *Quill* decision.**

Federal legislation has stalled in Congress in no small part because many Internet and catalog customers still don't understand their current tax payment obligations, which has enabled anti-tax forces to falsely characterize the federal legislation as imposing new taxes.¹⁷ If buyers — even those who nominally understand that the tax is owed — are continually reminded of that

¹⁷ For example, a recent appeal for grassroots opposition to a Utah law from Americans for Prosperity is titled "Tell Lawmakers NO on Internet Sales Tax!" and ends with "We need your help to fight against unfair tax increases — sign our petition and tell lawmakers you oppose an internet sales tax" — eliding the fact that sales taxes are already due on Internet sales. See <https://americansforprosperity.org/actions/tell-lawmakers-no-on-internet-sales-tax/>.

fact and confronted with a more credible threat of enforcement via the sharing of the purchase information with their state tax agency, they may eventually pressure their members of Congress to enact legislation shifting the responsibility for remitting the tax to the seller, where it belongs. Comprehensive information on the extent of buyer non-compliance that the annual purchase reports will provide will enable states to make a stronger case to Congress for enacting the legislation.

States Should Take Additional Steps to Help Buyers Self-Remit Sales Taxes

If states are going to require remote sellers to notify buyers of their legal obligation to self-remit sales taxes, they should take several steps to make it as easy as possible for buyers to comply:

- **All state revenue departments should create a special page on their websites where individual consumers can access all information needed to comply with self-remittance requirements.** These pages should describe buyers' legal obligations, provide a description of items typically purchased from remote sellers that are and are not subject to sales and use taxes (including the tax treatment of shipping and handling charges and products like gift baskets that include both taxable and exempt items), provide access to a database that allows consumers to enter their home address and obtain the combined state and local sales tax rate that is to be used in calculating tax liability, and provide a link to the instructions and forms for calculating the tax. The MTC version of Colorado's law requires the annual report to buyers to include "instruction for obtaining information regarding whether and how to remit the sales or use tax to the Department [of Revenue];" the inclusion in that notice of a statement to the effect that such information can be obtained by visiting a specific web page would appear to satisfy that requirement. States should also provide a toll-free number where the same information can be provided via an interactive voice-mail system, including an option to speak to a revenue department employee to have questions answered.
- **All states should allow all sales taxes associated with non-business purchases to be self-remitted annually.** Some states still require households to self-remit sales taxes quarterly; this should be changed to an annual filing requirement. For states with income taxes, the sales tax should be due at the same time as the income tax filing (typically April 15). A consumer sales tax return should be included in the income tax booklet or a line for reporting the sales tax should be placed on the income tax form.¹⁸ The latter is preferable since it allows any sales tax liability to be offset against any income tax refund. States without income taxes should include a link to their sales tax self-remittance forms on the web page devoted to this obligation.
- **All states should allow most buyers to use an income-based lookup table to calculate their sales tax liability rather than requiring them to review actual purchases upon**

¹⁸ Oklahoma has incorporated the following language into its tax code, and all states should consider doing so as well: "When assisting taxpayers in preparing an individual income tax return, tax preparers shall advise their clients of their responsibility to remit use taxes through the use tax remittance line on the individual income tax return or by filing a consumer use tax return." Oklahoma Statutes Section 68-249.D.

which tax was not charged. About a dozen states allow households to fulfill their self-remittance obligations by looking up an amount in a table that varies with gross income, rather than requiring them to review their purchase receipts, credit card bills, and cancelled checks to determine the actual amount of taxable purchases they made upon which tax was not charged.¹⁹ All states should provide this option; there is evidence that it increases self-remittance.²⁰ Most states limit this option to purchasers making less than \$1,000 in annual purchases, and such a limitation should be adopted by all states. Alternatively, states could require specific sales tax liability to be calculated for any individual item purchased with a value above, say, \$500, with such amounts used to adjust the amount determined using the table.²¹

Conclusion

The Colorado sales tax notification and reporting law is an innovative new tool that can help states collect a greater share of the sales tax they are owed by households and businesses buying from Internet and catalog merchants but that companies can't be required to charge. Now that its legality has been upheld by the courts, every state with a sales tax should adopt it at the earliest opportunity. Ideally, states will adopt the refined version of Colorado's law developed by the MTC, which includes a few substantive improvements.

The best and only truly comprehensive solution to the problem of uncollected sales taxes on remote sales remains proposed federal legislation that would authorize states to require all remote sellers to charge tax in exchange for greater simplification and interstate standardization of sales tax rules. In the meantime, however, states should do what they can to ensure that online shoppers pay their fair share of sales tax, that their in-state merchants compete on a level playing field, and that they themselves have the revenue they need to fund education, health care, infrastructure, and other vital services. Enacting this straightforward law can make a meaningful contribution to the achievement of each of these objectives.

¹⁹ Manzi, Note 16, p. 10.

²⁰ Manzi, Note 16, p. 10.

²¹ See Note 2 for greater explanation of the table.

Appendix:

Policy-Based Objections to Use Tax Notification and Reporting Laws Have Little Validity

As discussed in the body of this report, Internet and catalog retailers objected to Colorado's law on the grounds that it violated various provisions of the U.S. Constitution — especially the Commerce Clause ban on discrimination against interstate commerce.²² The industry initiated a legal challenge to Colorado's law based on these objections, but it failed.

The industry also has two major *policy-based* objections to the law, and these will continue to be raised as additional states contemplate enacting their own versions. The industry claims that the portion of the law that requires an annual report of customer purchases to the state revenue department violates consumer privacy. The industry also claims that the law taken as a whole imposes unreasonable costs and compliance burdens on remote sellers. These claims have little validity.

Privacy Issue Is Grossly Exaggerated

A bill was introduced (but not enacted) in the 2017 Colorado legislative session that would have repealed the requirement that remote sellers provide an annual report of total customer purchases to the state's department of revenue. Proponents of repealing this provision characterized it as a violation of consumers' right to privacy.²³ This claim is grossly exaggerated.

- **Both the Colorado and MTC versions of the law *explicitly* state that *no* information about the nature of the items purchased is to be furnished to the state department of revenue.** Both versions were deliberately written to strike a reasonable balance between consumer privacy and the states' need to compel self-remittance of sales tax when the seller does not collect it. All that the state tax agency will be told is, for example, that Jane Smith, residing at 444 Main Street, purchased \$800 worth of merchandise from Onlinestore.com in 2017. Since many online retailers sell a wide variety of merchandise, no one with access to these reports could draw any inference whatsoever about what was purchased. The only hypothetical privacy issue therefore attaches to what is likely to be a small minority of purchases for which knowing the name of the seller might provide some indication that sensitive items were purchased.
- **In nearly all cases, people purchasing items about which they might have privacy concerns will be able to avoid reporting of sensitive information to state revenue departments.** It seems unlikely that many people would be concerned that a state revenue department employee might have access to information showing that they bought items from Pottery Barn or Golfclubs.com. But the fact that someone patronized a seller with a

²² Read literally, the Commerce Clause merely affirmatively grants to Congress the authority to regulate interstate commerce. However, the U.S. Supreme Court has long held that it also contains implicit or “dormant” prohibitions on state policies that discriminate against interstate commerce even when Congress has not explicitly acted to prohibit them.

²³ Amy Stephens, “Colorado Should Rethink Its Tattletale Tax Reporting Law,” *Colorado Statesman*, February 22, 2017.

suggestive name might be information that the buyer would prefer no one other than their credit card company and the seller itself had access to. If privacy is someone's top priority, in almost all cases they will be able to buy the exact same item(s) from companies that sell a broad range of merchandise and thus avoid reporting of a more specific suggestive seller's name. For example, someone who doesn't want it reported to their state's department of revenue that they made a purchase from an online gun store can choose to buy the gun from a general online sporting goods store instead. Of course, that individual might prefer to buy from the more specific seller, but the need for states to be able to collect the sales taxes they are owed and the contribution that the revenue department reporting provision of the law makes to achieving this objective outweigh the buyer's desire to be able to buy from a *particular* retailer.

There may be other ways that buyers can avoid unwanted reporting to revenue departments of the remote sellers with whom they do business. In addition to selling on their own websites, many online retailers sell their merchandise through multi-retailer online marketplaces like those operated by Amazon and eBay. Colorado's regulation allows the marketplace rather than the ultimate seller to fulfill the annual revenue department reporting requirement, and the MTC is drafting language to mandate it. It seems likely that retailers selling sensitive items will begin selling through these marketplaces — assuming they don't already — and informing their privacy-focused customers that they can avoid reporting of the ultimate retailer's name to their state's revenue department by buying through the marketplace rather than directly from the retailer's website.

Finally, sellers of items about which people might have privacy concerns always have the option of voluntarily collecting sales tax on behalf of states even if they are not obligated to do so. Doing so would free them from having to report their customers' identities. If notification and reporting laws are adopted by a significant number of states, it seems likely that many businesses selling sensitive items online or through catalogs will elect to collect taxes rather than report their customers' purchases — especially if what they sell can be purchased from competing general merchandisers whose reports to revenue departments would not reveal any hint of the items purchased.

- **State revenue department personnel already have broad authority to access information about the specific items that specific people buy, but opponents of the Colorado law have provided no evidence of inappropriate accessing or disclosure of such information.** When a company is collecting sales tax on behalf of a state, it is subject to an audit to make sure it is charging tax properly. This often requires revenue department auditors to examine the *specific* items sold to a random sample of *specific* customers, to make sure the retailer is charging the correct tax on taxable items and, conversely, not charging tax on tax-exempt items (or items sold to tax-exempt customers).

Moreover, states frequently obtain some information about some customers' specific purchases that they use to enforce buyer remittance of sales taxes. For example, states often receive data from customs brokers identifying items that people traveling abroad buy and ship back to their homes. States also often share customer purchase information with other states when they audit in-state sellers of big-ticket items like furs, jewelry, and artwork and discover shipments of these items to customers in other states.

The remote seller trade associations that supported legislation to repeal the revenue department reporting provision of Colorado's law and have opposed the law's adoption by other states have ignored these existing examples of state revenue department access to customer purchase information in their attempt to paint the law as some kind of unprecedented intrusion on privacy. More importantly, they have not provided any evidence that revenue department personnel have inappropriately accessed or disclosed the customer purchase information to which they already have access.

State laws impose strict confidentiality standards on tax-related information and stringent civil and even criminal penalties for violating those standards. Opponents of the Colorado law have offered a reasonable criticism that it does not contain explicit language extending existing tax confidentiality standards to the annual revenue department reports of customer purchases. (The MTC model does.) Such a provision could easily be added to the Colorado law. But its absence should not be allowed to distract from the fact that state revenue department personnel already have access to considerable information about individual purchases and do their utmost to maintain its confidentiality. Even within state revenue departments, that access is tightly limited to staff whose responsibilities require it.

- **State and local government employees already have access to many other types of sensitive personal information, and there is little if any concern about this because inappropriate access and/or disclosure is exceedingly rare.** Some state revenue department personnel have access to information about the total amount and sources of families' incomes. Some school personnel know the names and ages of a family's children, where they attend school, and frequently, whether they have any significant physical, emotional, or learning problems. Some staff of state boards of elections know the party affiliations of registered voters. Some state health agency personnel have access to the complete medical records of families receiving Medicaid or Children's Health Insurance Program benefits. Some state and local government personnel have access to information about people who have been granted permits to carry concealed weapons or licenses to hunt (which is highly suggestive of gun ownership). Some state employees have access to records showing who purchases lottery tickets and who owns a boat.

It is ironic that an opponent of Colorado's law has sounded the alarm that "the state could glean intimate information on Coloradans' political inclinations, entertainment choices, medical issues, and financial status," since the state already has vast amount of information about all four of these categories.²⁴ Again, all indications are that the confidentiality of this information is scrupulously preserved with exceedingly rare exceptions.

Cost of Complying with Notification and Reporting Laws Likely Much Less than Cost of Collecting Sales Tax

Remote seller representatives have also criticized Colorado's law because of the compliance costs and efforts they say it will impose on these businesses. Whatever those costs may be, they need never be higher than the costs incurred by remote sellers that are actually obligated to collect and

²⁴ See the source cited in Note 23.

remit sales tax on behalf of a state: every remote seller can avoid the cost of complying with the notification and reporting law by voluntarily collecting and remitting the tax instead.

In fact, the efforts involved and costs incurred in complying with Colorado-type laws are likely to be far below those associated with ongoing collection and remittance of sales taxes.

Collecting and remitting sales taxes on remote sales requires sellers to distinguish taxable from exempt items (which vary from state to state), identify the current combined state and local tax rate(s) at the buyer's delivery location to calculate the tax to be placed on the buyer's bill, collect the tax from the buyer, compile all sales taxes collected from all buyers in a particular state during a specified time period and prepare and submit a sales tax return for that period, and remit the tax collected. Given the diversity of (and frequency of changes in) sales tax rates, exemptions, tax return formats, and other sales tax requirements among the states, accurate sales tax compliance requires the use of sophisticated and specialized computer software that is integrated into remote sellers' shopping cart software.²⁵ Even with tax software, significant manual work may need to be done — for example, identifying the nature of each new item offered for sale so that the software can code it as taxable or exempt in each state.

In contrast, complying with use tax notification and reporting requirements primarily requires a one-time fixed cost for the relatively straightforward computer programming needed to:

- Display text on a computer screen constituting the “each-purchase” notification (in the case of online sales) or print the notification on the order form in a catalog (which is already often personalized with the name and address of the purchaser);
- Generate the annual notification of total purchases to the buyer, which many remote sellers are probably already compiling to identify their highest-volume customers; and
- Generate the annual report to the state revenue department of total purchases of each in-state customer, which must be transferred electronically under the law and thus does not incur even minimal shipping costs.

The only significant cost that will vary with the number of customers a remote seller has is the cost of a separate annual mailing of the report to buyers totaling their purchases in the previous calendar year. The requirement of a separate annual mailing of this report is reasonable; it would very likely be ignored if it were enclosed in a shipment, and it might well end up in a “spam” filter if sent by email. However, there is no need to require that it be sent by first-class mail (as the Colorado law does), as long as the envelope is marked (as the Colorado law requires) “Important Tax Document Enclosed” to draw attention to it. The MTC model law allows for less-expensive bulk mailing of these reports. In addition, Colorado has already allowed (and the MTC is considering allowing) buyers to affirmatively opt in to receive the annual reports online rather than

²⁵ Several companies sell sales tax compliance software. For a sample, see: <http://www.streamlinedsalestax.org/index.php?page=Certified-Service-Providers>.

in hard copy. If implemented properly, this could be a reasonable alternative that could save remote sellers considerable mailing costs without sacrificing most benefits of the annual report.²⁶

The most important way that states can minimize the cost to remote sellers of complying with notification and reporting laws is to adopt as close to identical laws and regulations as possible. Compliance costs could rise quickly if the specifications for the two buyer notices and one report to the revenue departments vary among the states. While states can legitimately make different choices about the substantive elements of their sales taxes — for example, what to tax and at what rate to tax it — the basic objective of the reporting and notification law is a narrow one. There is very little justification for divergence among the states in how the law reads or how it is implemented. The MTC will carefully consider the relevant issues in finalizing its model, and, in the interest of minimizing compliance costs for remote sellers, its model should be given great deference by states that adopt such laws in the future.

While states have an obligation to do what they reasonably can to minimize compliance costs for remote sellers, there is no question that some new costs will be imposed. That is no justification for opposing enactment of these laws. In the absence of a federal authorization to states to require remote sellers to collect and remit sales taxes, they must do what they can to enforce the self-remittance requirements contained in their existing laws. For all the reasons discussed above, notification and reporting laws represent a valuable new tool in achieving this legitimate objective.

²⁶ One workable option would be to include in the “each purchase” notification a statement that the annual report can be obtained by clicking on an indicated link. The link would have to be to an always up-to-date compilation of year-to-date purchases, since the remote seller would not know whether any particular purchase would be the last one a particular customer would make in a particular year. (A number of prominent online retailers already allow customers to access an up-to-date history of previous purchases.) Of course, such an approach would be inferior to the current requirement for a report provided after the end of the year — closer in time to when the annual self-remittance of the tax would be due. Nonetheless, it might represent a reasonable compromise to reduce the cost of mailing the annual purchase report to buyers.