Sales and Use Tax Weakness & Possible Remedies: Use Tax Collection

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California's Use Tax Gap, A $1 Billion Problem

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Possible Remedies to the Use Tax Collection Problem

1. Establish a Public Awareness Campaign and Educational Activities
2. Mandate Use of Form 540 or Form 100 to Pay Use Tax
3. Clarify and Improve the Use Tax Line on Form 540
4. Implement Simpler Compliance Techniques for Individuals
5. Pursue Technological Solutions
6. Support Efforts to Find Non-Compliant Vendors
7. Encourage Out-of-State Vendors to Voluntarily Collect Use Tax
8. Avoid Legislation With a High Likelihood of Being Defeated
9. Work with Congress and Other States

The details of these remedies is included in this testimony following a brief background on California use tax collection, the importance of improving collection, and key challenges.

Introduction

Soon after the enactment of a sales tax in 1933, California enacted a *use tax* to ensure that tax was collected on taxable purchases made by California buyers even if the seller was not legally obligated to collect the sales tax. The use tax was intended to put California retailers on "an equal footing with their out of state competitors" who were exempt from the sales tax because they were not located in California.[2] While the sales tax is imposed upon the retailer (although they may pass it on to the buyer), the use tax is legally imposed upon the buyer. The rate and base for each tax is the same.

A seller without a physical presence in the state is not obligated to collect sales tax from buyers located in that state.[3] A non-present (remote) seller may still register with the taxing state and collect sales and use tax, but it is not obligated to do so. Remote sellers have been selling to California customers for decades primarily through catalog sales. E-commerce has brought about another sales approach that does not require the seller to have a physical presence in the state.

Many buyers likely believe that a purchase from a remote vendor is tax free because the buyers are not aware of the use tax. Also, little effort has been made by many states, including California, to educate buyers about the use tax. California followed the lead of many other states and added a specific line on Form 540 for the use tax.[4] This may cause taxpayers to go to the instruction book to learn about the tax. However, if an individual has not kept records of his taxable purchases during the year for which sales tax was not charged, it is difficult to properly comply with the use tax collection obligation at the time the Form 540 is due. Also, if a person does not know what a "use tax" is, they may just skip that line on the Form 540 altogether.

The e-commerce business model increases the use tax collection issue because that model enables businesses to easily sell to buyers in any state without having a physical presence there. The e-commerce model also enables a vendor to easily avoid all sales tax compliance by following a practice (and noting it on their website) that they ship from State X (where the vendor resides), but do not sell to customers in State X. This approach enables vendors to avoid collecting tax in State X (they have a physical presence there, but no sales) and in any other state because they only have a physical presence in State X. Also, it is easy for online shoppers to search online to find an out-of-state online vendor who does not collect sales tax.

A recent effort in California to improve use tax collection from businesses was enacted in 2009 (Chapter 16; AB x4-18). This legislation requires "qualified purchasers" to register with the Board of Equalization and pay use tax directly to the Board. A qualified purchaser has $100,000 or more of annual gross receipts from their business and is not required to hold a seller's permit (such as because they do not sell items subject to California sales tax).[5]

Additional efforts to improve use tax collection have been introduced in the legislature, several are similar to actions taken in other states. For example, so-called "Amazon bills" have been introduced following the action taken in New York in 2008. This approach provides a rebuttable presumption that a vendor with more than $10,000 of sales in twelve months generated from in-state "associates" who make commissions from a vendor link on their website, have sales tax nexus. Typically, such associates make a commission if a customer starts their order by first clicking on the associate's web link. The associates are typically not involved in any part of the ordering process and do not know what the customer purchased. AB 153 (2011) is the current California proposal for this approach to attempt to improve use tax collection by getting more vendors to collect the tax.

Challenges to the New York legislation were not successful at the trial court level, but appeals are still pending.[6]

Another approach, similar to legislation enacted in Colorado in 2010, would require vendors who are not required to collect sales/use tax to include information about use tax obligations on websites and catalogs. In addition, vendors with sales above a specified threshold would be required to report sales information to the state. AB 155 (2011) is a current proposal that takes this approach to try to increase use tax collections. AB 155 would also expand the definition of retailer engaged in business in this state for sales tax purposes to include a retailer that is a member of a commonly controlled group or combined reporting group if the in-state group member performs services pursuant to an agreement. Similar "affiliate nexus" bills have been enacted in other states.

In January 2011, the District Court in Colorado granted a preliminary injunction requested by the Direct Marketing Association to enjoin Colorado from enforcing its use tax notice and sales reporting legislation.[7]

Why Improve Use Tax Compliance

Reasons for improving use tax compliance include:

1. The use tax has been in existence since 1935; it is not a new tax. Improved collection will provide needed revenue for the state without the need to increase a tax rate or create a new tax.
2. Failure to collect use tax violates the principles of equity and neutrality. Equity and fairness are violated when taxpayers are able to purchase goods online without paying tax while others buying the same items at their local store pay the tax. Vendors with physical stores in California can find it difficult to compete with online vendors who can sell without collecting sales tax. Because so many consumers are unaware of their use tax obligation they do not factor it in when comparing

in-store to online prices. Also, when buyers perceive that online items are cheaper than the same items purchased at a physical store, they may be inclined to purchase online, thus further exacerbating the use tax collection problem.

Challenges

Confusion and lack of understanding of the use tax: Because consumers know so little about the use tax, improved enforcement is often viewed by many as the enactment of a new tax. This misunderstanding exists not only with many individuals, but also elected officials. For example, in vetoing a bill in July 2009 that would have attempted to get more Internet vendors to collect the use tax, Governor Schwarzenegger stated:

> "After passing the largest tax increase in California history, it makes absolutely no sense to go back to the taxpayers to solve the current shortfall - that's why yesterday I vetoed the majority vote tax increase passed by the legislature."[8]

A change from consumers self-assessing use tax to vendors collecting and remitting it instead, should not be viewed as either a new tax or a tax increase, but rather a change in collection and remittance responsibility. Such statements by high-ranking elected officials help promote confusion as to the nature of the use tax and can harm collection efforts.

Tax base complexity: Another challenge is that the current sales and use tax rules are not simple. Taxpayers need clear guidance as to which of their purchases are taxable and which are not, particularly where handling charges or services are associated with the purchase of tangible personal property.

U.S. Constitutional constraints and waiting for Congress: Challenges also exist in finding remedies that allow the state to have the preferred system of thousands of vendors collecting the use tax rather than relying on millions of consumers to self-report the tax. In 1992, the U.S. Supreme Court ruled in *Quill Corp. v. North Dakota*, 504 U.S. 309, that the commerce clause of the U.S. Constitution requires that a vendor have a physical presence in a state before the state can impose sales/use tax collection obligations upon it. While Congress has authority under the commerce clause to overturn or modify this ruling, it has not done so. Possible reasons for inaction by Congress include the complexity of varying state sales tax rules and the high costs of compliance if all vendors were required to collect and report sales/use tax in all state and local jurisdictions in which they have customers. Congress, states and vendors need to work together to find workable solutions to the use tax collection issue, and such efforts are difficult for various reasons.

Recommendations to Improve Compliance

1. *Establish a Public Awareness Campaign and Educational Activities*: While the Board of Equalization has undertaken some public awareness efforts, [9] there are still too many people who have not heard of a use tax or do not know what it is. Thus, when they see the "use tax" line on Form 540, they are likely to skip it.

   Possible activities include:

   - Website ads (including ones that can be posted at no charge on state agency websites) and radio ads that explain what the use tax is, how long it has existed, when it applies, how to calculate it and how to pay it. Information on the amount of uncollected tax should also be provided, perhaps in terms of how it compares to total tax collections or a favored government spending program, such as some part of K-12 education spending. In addition, reminders that if everyone paid their use tax, the state's budget problems would be lessened. An example of a descriptive ad from Michigan is included in this testimony at Exhibit C.

- Continued outreach to tax advisers. In early 2007 and later years, the Board mailed letters to tax practitioners in the state encouraging them to discuss use tax compliance with their clients. Greater and more frequent efforts are needed.
- State agency outreach. State agencies should be required to place use tax reminders on pay stubs throughout the year, addressing both recordkeeping and reporting requirements, with a URL provided for obtaining additional information. State mailing envelopes can include a reminder stamped on the outside about paying use tax.
- High school civics curriculum and standards should include knowing the basics of California's tax system and individual tax obligations.
- Elected officials should be encouraged to note in public statements, particularly during the filing season, that they paid their use tax and encourage their constituents to do so as well. The public needs to hear: *"I paid my use tax. Have you?"*

While the government would generally prefer to have vendors collect the sales tax rather than having consumers self-report, it is unlikely that the government can always rely on vendors. If a vendor is located outside of the U.S. (with no physical presence in the U.S.) it would be difficult, if not impossible, for the state to get the foreign vendor to collect the state's sales tax. In addition, proposals by Congress to allow states that have simplified their sales tax system to require remote vendors to collect the sales tax exempt small vendors. Thus, unless a state exempts sales from small vendors from the sales and use tax, consumers would still be required to self-report use tax when they purchase taxable items from such small vendors. Thus, individual consumers will likely always have a self-assessment obligation when it comes to the use tax. Thus, efforts are needed to make all individuals as aware of the use tax as they are of income taxes.

2. *Mandate Use of Form 540 or Form 100 to Pay Use Tax:* Some taxpayers, such as those with a seller's permit, are not allowed to report use tax on their Form 540. As noted in the Form 540 instructions (see Exhibit A to this testimony), an individual need not report use tax on Form 540, but can instead report and pay use tax directly to the Board of Equalization. This can create some confusion. In addition, it enables paid tax preparers to not pursue client reporting of use tax on Form 540 under the assumption that the client is reporting the tax on their own to the Board.

   This issue was noted in the Assembly analysis of AB 969 (5/23/07). That analysis noted that use tax reported on income tax forms for 2004 was $2.8 million, $4.6 million in 2005 and $5.5 million in 2006. Taxpayers who prepared their own return were eight times more likely to complete the use tax line than were taxpayers who used paid preparers. The sponsor of AB 969 believed this was due to the elective nature of reporting use tax on the income tax form. AB 969 proposed to make reporting of use tax on the income tax form mandatory to increase awareness and compliance. Eliminating the option of a non-business individual reporting use tax on a form other than Form 540 would also require paid tax return preparers to explain the tax to clients and require reporting of some amount (including zero if appropriate) on the line. A similar effect would result with tax preparation software.

3. *Clarify and Improve the Use Tax Line on Form 540*: The California Form 540 for 2010 includes the following use tax reporting line:

Use Tax **95** Use Tax. **This is not a total line** (see page 14) . . . . ● **95**_______________

   In contrast, the Michigan personal income tax form for 2010 has the following more descriptive use tax reporting line:

22.	**USE TAX**	Use tax due on Internet, mail order or other out-of-state purchases from Worksheet 1, line 3, p. 9.

Further improvement could be made to the Michigan line by noting that all taxpayers should report an amount on the line. That instruction is more likely to lead filers to learn about the tax. This improved instruction for the Form 540 should help increase compliance. In addition, should there continue to be an option of separately filing a use tax form with the Board of Equalization, a check box could be added following line 95 asking filers to check if they have filed such a separate report.

In addition to providing more details of the "use tax" on the reporting line, the instructions for Form 540 should be clarified and highlighted on a single page rather than spread over 3 pages. The Michigan instruction book has a single page devoted solely to the use tax. In addition, the 2010 California instructions state: "See page 19 for a general explanation of California use tax." Unfortunately, the instruction book ends at page 17 (there is no page 19).[10]

Exhibits A and B at the end of this testimony contain the individual income tax instructions for the use tax for California and Michigan, respectively.

4. *Implement Simpler Compliance Techniques for Individuals*: In a few states, including Maine, Michigan and New York, individuals are not be required to keep detailed records to calculate the actual use tax owed. Instead, they have the option of using a table prepared by the state tax agency to determine their use tax based on their income level. In these states, if each item purchased for which use tax is owed has a cost under $1,000, the tax table may be used to compute the use tax.[11] For purchases of single items costing $1,000 or more, the use tax for such items can be added to the table amount. The use tax table from the Michigan individual tax return instruction booklet follows:

TABLE 1 - USE TAX

AGI*	Tax
$0 - $10,000	$4
$10,001 - $20,000	$12
$20,001 - $30,000	$20
$30,001 - $40,000	$28
$40,001 - $50,000	$36
$50,001 - $75,000	$50
$75,001 - $100,000	$70
Above $100,000	Multiply AGI by 0.08% (0.0008)

* AGI from MI-1040, line 10.

Individuals are not required to use the table; they may instead keep records of how much use tax is owed.

The Michigan instructions also explain that the use tax line should not be blank. If there are no purchases subject to use tax, a "0" should be entered on the use tax line. The use tax instructions for the Michigan individual income tax return are included as Exhibit B at the end of this testimony.

Alternatively, Minnesota provides an exemption where use tax is not owed unless a person's purchases subject to use tax exceed $770 for the year.[12] However, this technique will not serve as well as the tax table approach to reduce recordkeeping. In Minnesota, individuals would still need to keep records of purchases to determine if the ones for which sales tax was not collected exceed $770.

AB 1957 (2008) called for an option to allow individuals to use a table to be provided in the Form 540 instructions where they could look up their use tax liability for non-business purchases. For individual non-business items subject to use tax that cost $1,000 or more, the actual use tax would have to be calculated.

The Form 540 instructions (see Exhibit A to this testimony) state that an amended 540 should not be used to amend the use tax line. Per page 19 instructions: "Changes in use tax reported. Do not file an Amended Income Tax Return (Form 540X) to revise the use tax previously reported. If you have changes to the amount of use tax previously reported on the original return contact the State Board of Equalization." This instruction buried in the 540 booklet is unlikely to be known by taxpayers or preparers and may also inhibit efforts to correct use tax errors including errors of prior omission.

5. *Pursue Technological Solutions*: Despite being in the information age today, states tend to rely on 1930's techniques for collecting use tax. Technological solutions include having the use tax charged to buyers at time of purchase. The buyer's credit card or Paypal account can be charged for the use tax by the state tax agency (rather than by the vendor). That is, the vendor charges for the cost of the goods/services and the state charges for the tax. This approach shifts the credit card fee for the use tax from the vendor to the state, eliminates reporting obligations for most, if not all, consumer purchases, speeds up collection time for the tax, and simplifies state audits of the use tax. Approaches could also be implemented to use such a collection system for catalog orders (those not over the Internet). Obstacles include consumer reluctance, but that might be removed if more consumers understand that the alternative is to implement better recordkeeping and self-report the tax on their income tax form. Use of a third party collector for the state could eliminate consumer concerns over the state having access to their credit card information. Vendor concerns might also be reduced as this system would be simpler and less costly than requirements to collect sales/use tax from all customers and file sales tax forms in all jurisdictions. States should work together, and with vendors, to pursue such a tax collection system.

6. *Support Efforts to Find Non-Compliant Vendors*: State auditors should continue efforts to find vendors with an in-state presence – either directly or through a sales representative, who are not collecting sales tax. Instead of focusing on legislative efforts that might be found to be unconstitutional (see recommendation #8 below), additional funding should be given to the Board to enable it to locate non-registered vendors that may indeed have a physical presence in the state through property, related entities, agents or representatives.

7. *Encourage Out-of-State Vendors to Voluntarily Collect Use Tax*: Remote vendors will be reluctant to voluntarily collect a tax they are not legally required to collect and with good reasons. There are costs associated with compliance including filing and additional credit card fees due to higher charges by customers (because the sales tax would be included on the charge). There are also competitive disadvantages of complying when other vendors do not as it will look like the compliant vendor's goods cost more. An advantage to collecting the use tax even when not legally required to do so would probably only exist if the state did a good enough job of educating taxpayers about their use tax obligations. Vendors could then advertise not to worry about use tax

compliance because they would handle it for their customers. Incentives for voluntary collection by vendors might include:

a. Offering compensation to vendors for collecting the use tax (to help cover their compliance costs).

b. Offering simplified compliance techniques, such as annual rather than quarterly reporting and providing technological tools to aid compliance.

c. Giving a preference to companies registered to collect use tax when the state makes purchases.

8. *Avoid Legislation With a High Likelihood of Being Defeated*: Legislation that can easily be avoided or that is likely to be challenged in course with a less than strong likelihood of state success, increases administrative costs for the state and delays actions on more productive collection activities. For example, North Carolina and Rhode Island enacted "Amazon legislation" similar to what New York enacted in 2008. It was reported that some affected vendors cancelled their agreements with associates in these states so it was no longer subject to the new legislation.[13] Thus, these states will not get the desired use tax collection boost they had hoped for. Legislation that is this easy to avoid is not worth the time to pursue enacting.

   In addition, after New York enacted its legislation in 2008, Board staff prepared a memo for a Board meeting on how the California sales tax law would apply to the associate relationship. The memo states: "Staff does not believe that a link on a retailer's affiliate's website suffices to establish that the affiliate is an authorized salesperson of the out-of-state retailer under section 6203(c). Consequently, under the current provisions of California law, staff does not require out-of-state companies to collect tax based solely on such links on affiliates' websites. However, other California activities an affiliate may engage in to promote the link may suffice to establish that the affiliate is an authorized salesperson of the out-of-state retailer. ... the existence of a link on an affiliate's website does not, on its own, conclusively create nexus."[14]

   In addition, given the recent injunction in Colorado regarding the state's pursuit of notice and reporting by certain remote vendors, it would likely be best for California to devote time to working with Congress on such a legislative approach at the federal level (within congressional commerce authority) rather than enacting something that will certainly be immediately challenged in the court with a less than strong likelihood of state success.

9. *Work with Congress and Other States*: California could encourage Congress to enact legislation that reverses or minimizes the effect of the U.S. Supreme Court decision of 1992 (the *Quill* decision) that requires a physical presence in order for a state to collect sales tax from a vendor. The Court's rationale for its holding was that imposing tax collection obligations on remote vendors would violate the commerce clause of the U.S. Constitution (it would impede interstate commerce). The Court noted that the commerce clause is within the purview of Congress (that is, Congress can determine what does and does not impede interstate commerce). Thus, Congress could enact a law allowing states to require remote vendors to collect sales and use tax from customers in the state, or require them to provide use tax notice and report information to states. However, Congress is unlikely to make such a change unless states greatly simplify their sales tax laws, which today, vary from state to state. States need to join efforts and approach Congress for assistance in reducing their use tax gaps.

   Several states have simplified their sales/use tax laws by adopting uniform rules established by the Streamlined Sales and Use Tax Project.[15] The hope of adopting states is that Congress will reverse the *Quill* decision for adopting states.[16]

California should also reconsider whether it should adopt the Streamlined Sales and Use Tax Agreement.

Additional Reference Materials

Nina Manzi, Minnesota House of Representatives Research Dept., "Use Tax Collection on Income Tax Returns in Other States," 12/04; updated June 2010; http://www.house.leg.state.mn.us/hrd/pubs/usetax.pdf.

Declan McCullagh, "States push to tax Net shopping," cnetNews.com, 4/12/06; available at http://news.com.com/2100-1028_3-6060450.html.

Exhibit A

Use Tax Instructions for 2010 California Individual Income Tax Return

From page 14 of the instructions: (http://www.ftb.ca.gov/forms/2010/10_540a_540ins.pdf)

Use Tax

Line 95 – Use Tax. This is not a total line.

California use tax applies to purchases from out-of-state sellers (for example, purchases made by telephone, over the Internet, by mail, or in person). For questions on whether a purchase is taxable, go to State Board of Equalization's website at **boe.ca.gov**, or call their Taxpayer Information Section at 800.400.7115 or TTY/TDD 800.735.2929.

Note: The following taxpayers are required to report purchases subject to use tax directly to the State Board of Equalization and may not report use tax on their income tax return:

- Businesses that have a California seller's permit.
- Businesses that are not required to hold a California seller's permit, but receive at least $100,000 in gross receipts.
- Individuals or businesses that have a California consumer use tax account.

If you are not required to report purchases subject to use tax directly to the State Board of Equalization, you may report use tax on your income tax return. To report use tax on your income tax return, complete the Use Tax Worksheet below.

If you owe use tax but you do not report it on your income tax return, you must report and pay the tax to the State Board of Equalization. For information on reporting use tax directly to the State Board of Equalization, go to their website at **boe.ca.gov**.

Failure to timely report and pay the use tax due may result in the assessment of penalties.

See page 19 for a general explanation of California use tax.

Use Tax Worksheet
Use whole dollars only.

1.	Enter purchases from out-of-state sellers made without payment of California sales/use tax. See worksheet instructions below	$ ________.00
2.	Enter the applicable sales and use tax rate.	___________
3.	Multiply line 1 by the tax rate on line 2. Enter result here	$ ________.00
4.	Enter any sales or use tax you paid to another state for purchases included on line 1. See worksheet instructions below.	$ ________.00
5.	Subtract line 4 from line 3. This is the total use tax due. Enter the amount due on line 95. If the amount is less than zero, enter -0-.	$ ________.00

Worksheet, Line 1, Purchases Subject to Use Tax

- Report items that would have been taxable if sold in a California store. For example, you would include purchases of clothing, but not purchases of prescription medicine.
- Include handling charges.
- Do not include any other state's sales or use tax paid on the purchases.
- Enter only purchases made during the year that correspond with the tax return you are filing.
- If you traveled to a foreign country and carried items back to California, generally the use tax is due on the purchase price of the goods you listed on your U.S. Customs Declaration less the $800 per-person exemption. This $800 exemption does not apply to goods sent or shipped to California by mail or other common carrier.
- If your filing status is "married/RDP filing separately," you may elect to report one-half of the use tax due or the entire amount on your income tax return. If you elect to report one-half, your spouse/RDP may report the remaining half on his or her income tax return or on the individual use tax return available from the State Board of Equalization.

  Note: Report and pay any use tax you owe on the following purchases directly to the State Board of Equalization, **not** on your income tax return:

- Vehicles, vessels, and trailers that must be registered with the Department of Motor Vehicles.
- Mobile homes or commercial coaches that must be registered annually as required by the Health and Safety Code.

From page 15 (continued from page 14):

- Vessels documented with the U.S. Coast Guard.
- Aircraft.
- Leases of machinery, equipment, vehicles, and other tangible personal property.

Worksheet, Line 2, Sales and Use Tax Rate

- Enter the sales and use tax rate applicable to the place in California where the property is used, stored, or otherwise consumed. If you do not know the applicable city or county sales and use tax rate, please go to the State Board of Equalization's website at **boe.ca.gov** and click on City and County Tax Rates or call their Taxpayer Information Section at 800.400.7115 or TTY/TDD 800.735.2929.

Worksheet, Line 4, Credit for Tax Paid to Another State

- This is a credit for tax paid to other states on purchases reported on Line 1. You can claim a credit up to the amount of tax that would have been due if the purchase had been made in California. For example, if you paid $8.00 sales tax to another state for a purchase, and would have paid $6.00 in California, you can claim a credit of only $6.00 for that purchase.

From page 16 (not a continuation of the above text):

Penalties. To avoid late payment penalties for use tax, you must report and pay the use tax with a timely filed income tax return, or California Individual Use Tax return.

From page 19 (of the complete 540 booklet):[17]

Additional Information

California Use Tax General Information

The use tax has been in effect in California since July 1, 1935. It applies to purchases from out-of-state sellers and is similar to the sales tax paid on purchases you make in California. If you have not already paid all use tax due to the State Board of Equalization, you must report and pay the use tax due on your state income tax return. See the information below and the instructions for line 95 of your income tax return.

In general, you should pay California use tax on purchases made from out-of-state (for example, by telephone, over the Internet, by mail, or in person) if:

- The seller does not collect California sales or use tax.
- You use, give away, store, or consume the item in this state.

Example: You live in California and purchase a dining table from a company in North Carolina. The company ships the table from North Carolina to your home for your use and does not charge California sales or use tax. You owe use tax on the purchase.

Complete the Use Tax Worksheet on page 14 to calculate the amount due.

Extensions to file. If you request an extension to file your income tax return, wait until you file your tax return to report your purchases subject to use tax and make your use tax payment.

Penalty. Failure to timely report and pay the use tax due may result in the assessment of penalties.

Changes in use tax reported. Do not file an Amended Income Tax Return (Form 540X) to revise the use tax previously reported. If you have changes to the amount of use tax previously reported on the original return contact the State Board of Equalization.

For assistance with your use tax questions, go to the State Board of Equalization's website at **boe.ca.gov** or call their Taxpayer Information Section at 800.400.7115 or TTY/TDD 800.735.2929. Income tax information is not available at this number.

Exhibit B

Use Tax Instructions for 2010 Michigan Individual Income Tax Return

Use Tax

Every state that has a sales tax has a companion tax for purchases made outside that state by catalog, telephone, or Internet. In Michigan, that companion tax is called the "use tax," but might be described more accurately as a remote sales tax because it is a 6 percent tax owed on purchases made outside of Michigan.

Use tax is due on catalog, telephone, or Internet purchases made from out-of-state sellers as well as purchases while traveling in foreign countries when the items are to be brought into Michigan. Use tax must be paid on the total price (including shipping and handling charges).

How to Pay Use Tax

Use Worksheet 1 below to calculate your tax and enter the amount of tax due on MI-1040, line 22.

Worksheet Calculation

Line 1: For purchases of $0-$1,000, multiply your total purchases times 6 percent (0.06) and enter the amount on Line 1, or

If you have incomplete or inaccurate receipts to calculate your purchases, you may use Table 1 - Use Tax to estimate your taxes. (See the following example.)

Line 1 should contain a number unless you made no purchases under $1,000 subject to the use tax. If we later determine that you owe use tax, you may be subject to penalty and interest.

Line 2: In all cases, if a single purchase is $1,000 or more, you must pay 6 percent use tax on those purchases.

Example: Kurt ordered a computer from a catalog retailer in New York for $1,437.50. Kurt also purchased items over the Internet for less than $1,000 during the year, but lost his receipts. He is sure he did not pay Michigan sales tax. Kurt's AGI is $46,500. Kurt would complete Worksheet 1 as follows:

Line 1: Kurt selects $36 from the table based on his AGI $36

Line 2: Kurt enters $1,437.50 x 6 percent $86.25

Line 3: Total use tax due $122.25

Kurt would enter $122 (no cents) on his 2010 MI-1040, line 22.

Estimating your taxes does not preclude Treasury from auditing your account. If additional tax is due, you may receive an assessment for the amount of the tax owed, plus applicable penalty and interest.

TABLE 1 - USE TAX

AGI*	Tax
$0 - $10,000	$4
$10,001 - $20,000	$12
$20,001 - $30,000	$20
$30,001 - $40,000	$28
$40,001 - $50,000	$36
$50,001 - $75,000	$50
$75,001 - $100,000	$70
Above $100,000	Multiply AGI by 0.08% (0.0008)

* AGI from MI-1040, line 10.

Use Tax on the Difference

If you paid at least 6 percent to another state on your purchase, you do not owe use tax to Michigan. If you paid less than 6 percent, you owe the difference.

Note: The full 6 percent use tax is owed on purchases made in a foreign country.

For more information, visit www.michigan.gov/taxes.

WORKSHEET 1 - USE TAX

Line 1: Itemized purchases of $0 to $1,000 x 6 percent (0.06) OR Use Tax table amount	$ ______
Line 2: Single purchases $1,000 or more x 6 percent (0.06)	$ ______
Line 3: Total Use Tax Due (add Lines 1 and 2)	$ ______

Enter amount from Line 3 above on your 2010 MI-1040, line 22. If the amount on Line 3 is 0, enter "0" on your 2010 MI-1040, line 22.

Source: http://www.michigan.gov/documents/taxes/MI1040book_341323_7.pdf (page 9).

Exhibit C

Michigan Use Tax Ad

INTERNET, MAIL ORDER AND OUT-OF-STATE PURCHASES

What is Michigan's Use Tax?

Every state with a sales tax has a companion tax for purchases made outside the state. In Michigan, that tax is called the "use tax" but might be more aptly described as a remote sales tax. As a general rule, you owe this tax if you purchased merchandise and did not pay sales tax. Typically this happens when you purchase an item (for example, clothing, books, furniture, computers) by telephone, catalog, Internet, or in person from out-of-state businesses that do not add the Michigan sales tax to your bill. While many Michigan residents are not aware of the use (remote sales) tax, it has been on the books since the 1930s.

Who Benefits from Michigan's Use Tax?

Stronger Schools: The direct beneficiary of nearly three-quarters of all sales tax and a third of all use tax is the state's K-12 school system.

Local and State Services: Local and state government services such as libraries, fire departments, road improvements, higher education, and public protection services are supported by sales and use taxes.

Michigan's Retailers: Collection of this tax will ensure a level playing field for Michigan businesses. Without collection of this tax, out-of-state retailers enjoy a 6 percent competitive price advantage.

These companies collect Michigan tax. If you order from these companies your responsibility is met.

Amway Corporation
Borders Online, Inc.
Gateway Companies, Inc.
Crate and Barrel
Eddie Bauer, Inc.
Herman Miller, Inc.
JC Penney Company, Inc.
K Mart Corporation
QVC Network Inc.
Talbots, Inc.
Wal-Mart Stores, Inc.
Walt Disney Catalog Inc.
Williams-Sonoma, Inc.
...and many more

These companies do not collect Michigan tax. If you order from these companies you need to file and pay tax. Save your receipts!

Amazon.com, Inc.
Coldwater Creek Inc.
DAMARK International, Inc.
Dell Catalog Sales, L.P.
Fingerhut Companies, Inc.
L.L. Bean, Inc.
Lands' End, Inc.
Spiegel Catalog, Inc.
The Orvis Company, Inc.
....and many more

If you are unsure of the amount of purchases on which you owe the use tax, contact the company from which you made the purchase.

*The above lists are intended as helpful guidelines and are **not all inclusive**. They are examples of companies that collect the tax for you and companies that leave the burden of compliance with you.*

For more information on the Use (Remote Sales) or visit our web site at: www.michigan.gov/treasury

3

Source: http://www.michigan.gov/documents/use_p3_2773_7.pdf.

1 This testimony is based on one in a series of reports on weaknesses in California's tax system. Report #1 lists several structural weaknesses and policy issues that exist in most of California's taxes and the system overall. Subsequent reports provide further details on the weaknesses and issues, along with possible remedies. The purpose of this series of reports is to help promote serious discussion on the need to and the ways to bring California's tax system into the 21st century so it may best promote economic growth, be more equitable, efficiently meet state revenue needs, reduce taxpayer frustration, and be understandable and transparent. A blog accompanies these reports to enable online discussion and a website exists to access the reports and blog. See http://www.21stcenturytaxation.com/.

2 *Bank of America National Trust and Savings Association v. State Board of Equalization*, 209 Cal App 2d 780, 26 Cal Rptr 348 (First App Dist 1963).

3 This standard was confirmed by the U.S. Supreme Court in *Quill Corporation v. North Dakota*, 504 U.S. 298 (1992) and *National Bella Hess .v Department of Revenue of Illinois*, 386 U.S. 753 (1967).

4 The line was added to the individual and corporate income returns (Forms 540 and 100) to cover purchases of tangible personal property made on or after 1/1/03 through 12/31/09 (SB 1009, Chapter 718, 2003). Sellers registered for sales tax may not use this reporting approach. Use of the income tax reporting approach constitutes an irrevocable election to use that technique rather than the regular reporting method for sales and use tax. SB 858 (Chapter 721; October 2010) makes permanent the requirement to have the use tax line on Forms 540 and 100. Such reporting constitutes an irrevocable election to report qualified use tax in that manner (on the income tax form).

5 See R&T §6225 and http://www.boe.ca.gov/sutax/useTaxRegFAQ.htm.

6 *Amazon.com, LLC v. Dept. of Tax and Finance*, NY SCt., App. Div., Docket 601247/08, 11/4/10; *Overstock.com, Inc. v. Dept. of Tax and Finance*, NY SCt., App. Div., Docket 107581/08, 11/4/10.

7 Civil Case No. 10-cv-01546-REB-CBS (1/26/11).

8 Governor's press release of July 1, 2009 (12650) ; also see California Chamber of Commerce press release of July 2, 2009 which includes the governor's statement; http://www.calchamber.com/Headlines/Pages/GovernorVetoesCalChamberOpposedInternetTaxationProposal.aspx. While the author of this testimony agrees with the reason to veto such legislation, often referred to as "Amazon legislation," the statement about it representing a tax increase was incorrect and likely damaging to efforts to improve understanding of the use tax.

9 The Board of Equalization used online advertising in 2005-2006 as noted in its *2006-2006 Annual Report*, p. 63; available at http://www.boe.ca.gov/annual/pdf/2006/7-needs06.pdf.

10 The page confusion seems to be that the FTB website includes a shortened version of the 540 instructions that ends at page 17 (http://www.ftb.ca.gov/forms/2010/10_540a_540ins.pdf). There is also a "booklet" link at the bottom of the individuals form website that has page 19 (http://www.ftb.ca.gov/forms/2010/10_540bk.pdf). Individuals who only find the shortened version with the reference to the non-existent page 19 are likely to conclude that the information is not important since it was omitted.

11 Maine requires a separate use tax form for individual items costing over $5,000 for which use tax is owed; the form must be filed by the 15th day of the month following the purchase; http://www.maine.gov/revenue/salesuse/usetax/usetax.html.

12 Minnesota 2010 Individual Income Tax instructions, page 13; http://taxes.state.mn.us/Forms_and_Instructions/m1_inst_10.pdf.

13 "2 more Web retailers cancel R.I. ties," Paul Grimaldi, *The Providence Journal*, 7/2/09, http://www.projo.com/news/content/BZ_INTERNET_SALESTAX02_07-02-09_3TETKSD_v10.31cc9a6.html.

14 BOE Memo of June 19, 2008 to Mr. Ramon J. Hirsig from Randie L. Henry; http://www.boe.ca.gov/meetings/pdf/070808nexus.pdf.

15 The Streamlined Sales and Use Tax Project began in 2000. The Streamlined Sales and Use Tax Act (SSUTA) and other information on the project can be found at http://www.streamlinedsalestax.org. The Board of Equalization has a background paper on the SSUTA at http://www.boe.ca.gov/legdiv/pdf/Streamlined_Sales_and_Use_Tax_Agreement.pdf (7/6/09).

16 Various bills have been introduced over the past few years, including H.R. 5660 (111th Congress), the Main Street Fairness Act, which would allow states that are members of the Streamlined Sales and Use Tax Agreement to collect tax from remote vendors. An exception would be provided for small vendors (not defined in the legislation). See http://thomas.loc.gov/cgi-bin/bdquery/z?d111:h.r.05660:.

17 See footnote 10.