



Uniformity Developments Staff Report

UNIFORMITY COMMITTEE
LONG BEACH, CALIFORNIA
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GLOBAL

“DIGITAL SERVICES TAXES, DESTABILIZATION, AND THE ROCKY ROAD TO PILLAR 1”

FORBES, FEB. 27, 2023

- Article reviews how the OECD’s Pillar 1 – which:
 - Imposes economic nexus jurisdiction
 - Apportions certain income using a receipts factor
- Is tied to its proposed prohibition on digital services taxes (DSTs).
- It notes that the OECD recently released a proposed definition of DSTs for comment.

“DIGITAL SERVICES TAXES” (CONT’D)

Proposed Definition: the term “digital services tax or relevant similar measure” would mean:

any tax. . . if it meets all of the following criteria . . .:

a. . . . is determined primarily by reference to the location of customers or users, or other similar market-based criteria;

b. . . . either:

i. is applicable by its terms solely to persons that:

1. . . . “non-residents”; or

2. . . . “foreign owned businesses”; . . .

and

c. such tax is not treated as an income tax under the domestic law

“DIGITAL SERVICES TAXES” (CONT’D)

The article notes that, “To the chagrin of several commentators, the OECD has drafted several proposed exclusions from the definition of DSTs and relevant similar measures.”

These exclusions include:

- a rule that addresses artificial structuring to avoid traditional permanent establishment or similar domestic law nexus requirements that are based on physical presence . . .;
- value added taxes, goods and services taxes, sales taxes, or other similar taxes on consumption; or
- generally applicable taxes imposed with respect to transactions on a per-unit or per-transaction basis

“DIGITAL SERVICES TAXES” (CONT’D)

In general, the article notes that the OECD has set deadlines for Pillar 1 that will affect when and if the DST prohibition goes into effect, which is December of this year, and it says:

“However, there are concerns the OECD might not meet that deadline. . . .Meanwhile, some countries are waiting in the wings to spring digital services measures into action. Colombia just enacted a significant economic presence rule that will go into effect in January 2024; Canada and the United States continue to spar over Canada’s planned DST.”



FEDERAL



IRS “GREEN BOOK” FOR 2023

HERE - [HTTPS://HOME.TREASURY.GOV/SYSTEM/FILES/131/GENERAL-EXPLANATIONS-FY2024.PDF](https://home.treasury.gov/system/files/131/general-explanations-fy2024.pdf)

- To accompany the Administration's Budget, Treasury releases the "General Explanations of the Administration's Revenue Proposals" which provides an explanation of the Administration's revenue proposals for that fiscal year.
- Given that many states generally or partially conform to the Internal Revenue Code – proposals can signal what may be coming.

IRS “GREEN BOOK” FOR 2023 (CONT’D)

- The 2023 proposals include one which would “prevent basis shifting by related parties through partnerships.”
- The proposal is **estimated to raise \$64 Billion in federal revenue over the next 10 years.**

The proposal describes the problem:

Under current law, related-party partners may use a section 754 election to shift basis between partners and achieve an immediate tax savings for the partners as a group without any meaningful change in the partners’ economic arrangement. More specifically, in partnerships with related-person partners, a partnership basis step-up could be designed to shift basis from non-depreciable, non-amortizable partnership property to depreciable or amortizable partnership property, resulting in immediate increases in depreciation or amortization deductions for remaining partners related to the distributee-partner.

“AUDIT RATES DECLINE FOR CORPS., PARTNERSHIPS, IRS DATA SHOWS”

DAVID VAN DEN BERG, LAW360-FEDERAL TAX, APRIL 14, 2024

Reports that the IRS Data Book shows that **audit rates for partnerships fell to 0.1% in 2018 from 0.3% in 2012**, the most recent year for which final audit rate data is available, noting also that: “The data book figures show that resource limitations have hindered agency work to address high-end noncompliance, the IRS said.”

“HOUSE LAWMAKERS RELAUNCH THE SALT CAUCUS”

KATE DORE, CNBC, FEB. 13, 2023

Reporting that:

- A group of bipartisan House representatives relaunched the state and local tax caucus last week, calling for relief from the \$10,000 limit on the federal deduction for state and local taxes.
- It's been a key issue for certain lawmakers in high-tax states because taxpayers can't deduct more than \$10,000 in state and local levies on their federal returns.
- However, without a unified proposal and few opportunities for a vote, repealing the SALT deduction limit may be challenging.



MTC

“THE SCOPE OF DIGITAL SALES TAX REFORM”

ADAM THIMMESCH, TAX NOTES TODAY – STATE, APRIL 11, 2023

“The growth and evolution of the digital economy have undermined state tax systems in ways that are well recognized. The inability of state tax systems to respond to market changes has resulted in tax bases that are underinclusive of the modern economy, inefficient tax differentials between “old” and “new” economy actors, and revenue losses for states. Taxpayers have also been faced with a lack of uniformity between states, uncertainty about their tax obligations, and the development of law through administrative rather than legislative action. We also see states pursuing new avenues for taxing digital revenue streams, like digital services taxes or data mining taxes. **In light of these challenges, there is broad agreement that digital tax reform is needed and that uniformity between states in that reform would best serve national industry actors.”**

“THE SCOPE OF DIGITAL SALES TAX REFORM” (CONT’D)

“The Multistate Tax Commission is among the parties to recognize these needs, and in the summer of 2021, it authorized a project to study digital tax reform in the context of the state sales tax. The MTC’s uniformity committee spent the next year researching and conducting stakeholder interviews.⁴ The MTC talked with a large group of stakeholders, including state revenue departments, taxpayers, practitioners, members of interested professional organizations, and academics, and it ultimately issued a proposed outline of a white paper on August 2, 2022. **That outline impressively reflected the numerous issues involved with updating states’ sales tax laws for the digital economy and provided a starting point for future work.”**

“THE SCOPE OF DIGITAL SALES TAX REFORM” (CONT’D)

“After the release of the draft white paper, concerns began to emerge from industry representatives that the MTC project might be overstepping. Written comments expressed apprehension with the scope of the MTC’s project and whether its definition of digital products suggested that the project would lead to tax expansion.”

...

“The MTC’s early work and meetings evidence the difficulty of the task before the working group. The challenges of digital tax reform are complicated. Managing those challenges along with the unique considerations and challenges of attempting reform in nearly 50 states can start to seem impossible.”

“THE SCOPE OF DIGITAL SALES TAX REFORM” (CONT’D)

“**The MTC project is a step in the right direction regardless of its ultimate scope.** . . . A narrow focus could fail to leverage the lessons learned in other projects related to the digital economy, fail to help states fully understand the technological backdrop against which new rules need to be drafted, and miss the opportunity to provide reform that is more able to handle future market changes.”

. . .

“Also, the digital economy is not the root cause of the weaknesses in the state sales tax. The need for digital tax reform is a symptom of deeper issues. The state sales tax is an instrument of the 1930s that has been patched up and upgraded over the intervening decades. **A tax base that was originally focused on sales of tangible personal property has been expanded through piecemeal reforms to add definitions of additional transactions included in the base. Similarly, business input exemptions have not been updated to capture all business consumption, and states have become heavily reliant on the revenue provided by that overbreadth in the tax base. Narrow tax reform efforts will likely fail to address those issues.**”

“THE SCOPE OF DIGITAL SALES TAX REFORM” (CONT’D)

“In sum, there is considerable merit to the MTC taking a broad look at the digital economy and at the types of reforms that might move states closer to an ideal consumption tax system.

There are certainly concerns that should be addressed if the MTC is to go that route, but those concerns seem manageable and insufficient to settle for a project that is more narrow than otherwise desired. It might ultimately be that a project with multiple stages or a project undertaken in coordination with another group, like the Streamlined Sales Tax Governing Board or the NTA, is warranted. Again, though, only by undertaking a broad approach will the project be able to advance the ball in that way.”

“THE PERILS OF THE MTC'S DIGITAL PRODUCTS TAX PUSH”

JARED WALCZAK, TAX NOTES – STATE, APRIL 17, 2023

“The Multistate Tax Commission has taken up an ambitious project of defining digital products to facilitate taxability determinations. On paper (or is that too last century?), **the task does not appear unusually difficult**: Most of us intuitively understand when a good or service is digital and can instinctively grasp how — in the context of digital products — a digital watch is not, but an e-book is. **Of course, the digital world is full of edge cases, and simple definitions can yield outcomes we intuitively know are “wrong.”** But the fundamental flaw in the MTC’s project is not that the question it seeks to answer is difficult, but that it’s the wrong question altogether.”

“THE PERILS OF THE MTC'S DIGITAL PRODUCTS TAX PUSH” (CONT'D)

“The MTC cautions that its **goal is not to advocate for the taxability of all digital products**, but a self-described uniformity project arising from an entity called the Multistate Tax Commission with a stated mission of **“promot[ing] uniform and consistent tax policy and administration among the states”** cannot help but be viewed through that lens. Indeed, even in the cautious statements of MTC presenters at the now-monthly meetings on Sales Tax on Digital Products — from the name, you might well conclude that the purpose of defining these products is that they might be subject to sales tax — **routinely slip into language about how to tax these products.”**

“THE PERILS OF THE MTC'S DIGITAL PRODUCTS TAX PUSH” (CONT'D)

“But let’s be transparent about this: The real money isn’t in your Spotify account, your Netflix subscription, or that next Kindle book. It’s in digital controls, cloud computing, inventory management, automated production lines, digital payments, machine learning, software (and platform and infrastructure) as a service, digital advertising, and data processing.

In short, the basic project of defining digital products for tax purposes is to create a massive inventory of business inputs, many either untaxed or only partially taxable at present (whether in tangible or digital form), and to slip them into sales taxes that are supposed to be imposed on retail transactions.”

“THE PERILS OF THE MTC'S DIGITAL PRODUCTS TAX PUSH” (CONT'D)

“Sales tax codes already include far too many business-to-business transactions, yielding tax pyramiding. The goal of reformers for decades has been to reduce the number of intermediate transactions captured by sales tax bases.⁴ **The upshot of broad digital products taxation would be to give up the whole game, and — as our economy becomes increasingly digital — to transform state sales taxes into something more akin to high-rate gross receipts taxes.” . . .**

“The MTC’s Uniformity Committee, in establishing the working group, suggested as a goal **“determin[ing] the best approach to making existing state sales taxes adaptable and responsive to changes in the digital economy as opposed to creating a new tax or looking at gross receipts taxes.”** In one respect, this is commendable: The MTC is right to acknowledge that the appropriate response to the emergence of new categories of economic transactions is to modify sales tax bases, not to create new targeted excise taxes or to return to the bad old days of gross receipts taxes. An important qualification should be added, however: This exercise makes sense **only insofar as the new economic activity is rightly subject to consumption taxes.”**

“THE PERILS OF THE MTC'S DIGITAL PRODUCTS TAX PUSH” (CONT'D)

“Unlike the Streamlined Sales Tax Governing Board and similar bodies, the MTC is composed not of legislative representatives — but of state tax administrators. They are experts in tax administration and offer excellent insights into technical questions involving tax uniformity, but they are not a policymaking community, nor were they intended to be.

In other intergovernmental bodies, a participant speaks for the state, or at least some element of it. Under the MTC approach, each participant speaks only for themselves, and not in their formal capacity as officials within their respective state governments, **but the resulting work product tends to be seen as a consensus of the state policy community.**

“THE PERILS OF THE MTC'S DIGITAL PRODUCTS TAX PUSH” (CONT'D)

On mere technical questions, this may not be of much importance, and their contributions can be of utmost value — drawing on their expertise as tax administrators. **But while the definition and taxability of digital products involves many technical details, these are ultimately policy questions of the greatest import.** The answers to these questions could fundamentally remake state sales tax codes. That is a matter for policymakers — not one that can be easily outsourced to an intergovernmental state tax agency in which no elected officials participate.

The working group is filled with smart, public-spirited people doing their best on a difficult issue. But whatever expertise the group may bring to these questions, promulgating a uniform approach to the sales taxability of digital products is not something that should be left to agency officials on conference calls — particularly if that approach would lead to substantial business tax increases across the country.”



OTHER



“COALITION MOUNTS EFFORT TO AMEND TAX INJUNCTION ACT”

AMY HAMILTON, TAX NOTES TODAY – STATE, APRIL 19, 2023

“A coalition is lobbying Congress to amend the Tax Injunction Act out of increasing concern that challenges to state taxes involving questions of federal law or the U.S. Constitution are not reviewed by federal courts.”

...

“According to prominent practitioners, there had been informal talk in the past . . . But other federal priorities dominated the focus of multistate business taxpayers.”

...

“Times have changed. **Two catalysts behind the campaign to modernize the TIA are the Supreme Court’s 2018 decision in South Dakota v. Wayfair Inc. and the Multistate Tax Commission’s 2021 revised statement of information on the application of P.L. 86-272 to modern business activities. . . .”**

“COALITION MOUNTS EFFORT TO AMEND TAX INJUNCTION ACT” (CONT’D)

““When we talk to a lot of different offices, what they don’t realize is it’s not only sales taxes,” Canning said. “It’s kind of this combination of what the justices said in Wayfair coupled with P.L. 86-272 interpretations by folks like the MTC. ‘What are the protections now? What is required from a nexus standpoint?’”

...

““The coalition also expects cases to arise from likely state attempts to tax digital products and other aspects of the digital economy, Canning said. Although states flush with federal COVID relief money held off on adopting digital advertising taxes in 2022 while monitoring litigation challenging Maryland’s tax, they will eventually seek new sources of revenue, Canning said, adding that both digital products and out-of-state corporations will likely be prime targets. **Lawmakers in multiple states this session have introduced a variety of measures to tax digital advertising services, and an MTC work group is developing a white paper on state sales taxation of digital products. . . .**”

“COALITION MOUNTS EFFORT TO AMEND TAX INJUNCTION ACT” (CONT’D)

“Consider this: P.L. 86-272 and ITFA — two of the best-known federal laws limiting the state taxation of interstate commerce — were not adopted until decades after the TIA was enacted. As is the case with federal laws enacted under Congress’s authority to regulate interstate commerce, neither P.L. 86-272 nor ITFA has its own accompanying Treasury regulations.”

““The measure passes and there’s not much to implement, and that’s always been part of the problem,” Canning said. “How do we get guidance on what Congress intended other than by lawsuits and legislative history?””

“(The MTC answered that question by taking matters into its own hands with its P.L. 86-272 project; organization officials repeatedly cited the need for states and taxpayers to have updated guidance and the lack of any federal regulatory body responsible for providing it.)”

“COALITION MOUNTS EFFORT TO AMEND TAX INJUNCTION ACT” (CONT’D)

“Further complicating matters is that controversies over a state’s interpretation of the federal preemptions contained in ITFA and P.L. 86-272 go to state, rather than federal, courts. “This is another reason why federal court jurisdiction is so important,” Canning said. “Having all 50 states separately interpret the Internet Tax Freedom Act is, obviously, not ideal.””

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QUESTIONS – COMMENTS?

THANK YOU

