

**FINAL  
FISCAL NOTE**

<b>Drafting Number:</b> LLS 11-0828	<b>Date:</b> July 29, 2011
<b>Prime Sponsor(s):</b> Rep. Stephens; Schafer Sen. Spence; Brophy	<b>Bill Status:</b> Postponed Indefinitely <b>Fiscal Analyst:</b> Natalie Mullis (303-866-4778)

**TITLE:** CONCERNING THE POLICY OF THE STATE OF COLORADO REGARDING NOTIFICATION OF USE TAXES DUE ON SALES MADE BY OUT-OF-STATE RETAILERS.

<b>Fiscal Impact Summary</b>	<b>First Year Lawsuit Resolved or Injunction is Lifted</b>	<b>Year After Lawsuit Resolved or Injunction is Lifted</b>
<b>State Revenue</b> General Fund - Sales and Use Tax	(\$12.3 million) /a <i>In FY 2011-12 dollars</i>	(\$16.9 million) /a <i>in FY 2012-13 dollars</i>
	<b>FY 2011-12</b>	<b>FY 2012-13</b>
<b>State Expenditures</b> General Fund	(\$72,906) /b	(\$21,449)
<b>FTE Position Change</b>	(1.0 FTE) /b	(0.5 FTE)
<b>Effective Date:</b> The bill was postponed indefinitely by the Senate State, Veterans, and Military Affairs Committee on May 11, 2011.		
<b>Appropriation Summary for FY 2011-2012:</b> See the State Appropriations Section.		
<b>Local Government Impact:</b> Undetermined decrease in revenue.		

/a Figures shown are the estimated impact on state revenue during the year and the year after the preliminary injunction related to the Direct Marketing Association vs. Huber lawsuit is lifted or the lawsuit is resolved. The revenue impact is based on current law and presumes the plenary power of the General Assembly. Regardless of the outcome of the lawsuit, state revenue will be reduced by about \$20,000 each year beginning in FY 2011-12 as a result of the repeal of the first section of House Bill 10-1193.

/b Of the expenditure and FTE savings for FY 2011-12, \$51,457 and 0.5 FTE is conditional, predicated on the Direct Marketing Association terminating its lawsuit against the Department of Revenue as a result of this bill.

**Summary of Legislation**

House Bill 11-1318 repeals House Bill 10-1193 and related Department of Revenue regulations. In addition, House Bill 11-1318 requires an out-of-state retailer with more than \$500,000 in annual gross sales that does not collect Colorado sales tax to notify consumers that use tax may be due on the purchase. The bill also prohibits these retailers from advertising that no tax is due on purchases made from the retailer.

## **Background**

Colorado residents are required by law to voluntarily declare and pay use tax on purchases from out-of-state firms of taxable tangible personal property used within the state if sales tax has not already been collected and remitted by the firm. Effective March 1, 2010, House Bill 10-1193 contains two sections designed to improve sales and use tax compliance, both of which are repealed by House Bill 11-1318.

The **first section** affects out-of-state retailers that are part of a "controlled group of corporations," which is an IRS designation that defines firms that are legally related to each other. House Bill 10-1193 requires retailers to collect and remit state and local sales tax from Colorado residents if they are part of a controlled group that has a retailer with a physical presence in the state and that retailer engages in constitutionally sufficient solicitation in Colorado.

The **second section** of House Bill 10-1193 requires retailers with more than \$100,000 of gross sales to Colorado consumers and that do not collect Colorado sales tax to do the following:

1. at the time of purchase, notify customers in Colorado that they are required to file a use tax return if sales tax has not been paid on taxable purchases;
2. report to each customer in Colorado annually by January 31 the total amount of purchases made by that customer during the previous calendar year; and
3. report to the Department of Revenue annually in March each Colorado customer's contact information and total amount of purchases.

House Bill 10-1193 requires retailers to be fined \$5 per customer for failing to provide notice of the tax requirement to customers and \$10 per customer for failing to provide notice of the annual sales amount to the Department of Revenue.

On June 30, 2010, the Direct Marketing Association (DMA) filed a lawsuit against the Department of Revenue (Direct Marketing Association v. Huber) in Colorado Federal District Court challenging the constitutionality of the **second section** of House Bill 10-1193 and related Department of Revenue regulations. On January 26, 2011, the Court granted a preliminary injunction against the enforcement of the reporting requirements contained in the second section. As of the release of this note, the preliminary injunction remains in effect. The first section of House Bill 10-1193 is unaffected by the lawsuit.

## **State Revenue**

General Fund revenue will decrease by an estimated \$12.3 million and \$16.9 million during the first year and the year after the preliminary injunction related to the Direct Marketing Association vs. Huber lawsuit is lifted or the lawsuit is resolved. Regardless of the outcome of the preliminary injunction or the lawsuit, state revenue will decrease by about \$20,000 annually as a result of the repeal of the first section of House Bill 10-1193.

It is unknown when or if the preliminary injunction will be lifted or when the lawsuit will be resolved. This estimate is based on current law and presumes the plenary power of the General Assembly. Furthermore, it assumes that, upon resolution of the injunction or the lawsuit, the Department of Revenue will not retroactively require the implementation of the second section of House Bill 10-1193 to tax year 2010. If they do apply it retroactively, the revenue impact will increase cumulatively. Should the Direct Marketing Association prevail against the Department of Revenue, the repeal of the second section of House Bill 10-1193 would not impact state revenue because the mechanisms that drive the revenue impact of that section would not be implemented regardless of House Bill 11-1318.

It is assumed that passage of this bill would release retailers from all annual reporting requirements related to the second section of House Bill 10-1193, including for the time period during which House Bill 10-1193 was in effect. It is estimated that about \$200,000 of use tax revenue will continue to be collected each year because of increased voluntary compliance resulting from media and other reporting related to House Bill 10-1193 and the notices required by House Bill 11-1318.

The estimate for total uncollected sales and use tax is based on a report by Donald Bruce, William F. Fox, and LeAnn Luna of the University of Tennessee.<sup>1</sup> Uncollected sales taxes by both the state and local governments in Colorado are estimated at \$130.7 million in calendar year 2010. Based on data from the 2007 Census of Government Finance, U.S. Census Bureau, the state collects 43.3 percent of all sales taxes paid to state and local governments. Of this amount, an estimated 49 percent is attributable to business-to-consumer transactions. Further, under House Bill 10-1193, Colorado was expected to initially collect about 45 percent of previously uncollected tax obligations from out-of-state retailers as a result of the enforcement provisions in the second section of the bill; this reduced collection rate is due, in part, to a de minimus requirement in the regulation that exempts retailers making less than \$100,000 in total gross sales in Colorado. Expectations for tax collections that would have occurred under House Bill 10-1193 increase between the first and later years after the resolution of the lawsuit because awareness of the law is expected to be phased in over time such that Colorado is ultimately expected to collect about 60 percent of previously uncollected tax obligations from out-of-state retailers.

## **State Expenditures**

**Department of Revenue — (\$72,906) General Fund and (1.0) FTE in FY 2011-12.** Of this amount, (\$51,457) General Fund and (0.5) FTE is conditional, predicated on the Direct Marketing Association terminating its lawsuit against the Department of Revenue as a result of House Bill 11-1318. Table 1 summarizes expenditure changes under House Bill 11-1318.

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<sup>1</sup> "State and Local Government Sales Tax Revenue Losses from Electronic Commerce" by Donald Bruce, William F. Fox, and LeAnn Luna. The University of Tennessee, April 13, 2009.

As a result of House Bill 10-1193, the department was appropriated 0.5 FTE and \$21,449 General Fund on a permanent basis to maintain records regarding online retailers and increase compliance with the use tax. These expenditures will be saved annually as a result of House Bill 11-1318.

The Direct Marketing Association lawsuit required a temporary increase of 0.5 FTE and \$31,457 General Fund for personnel services and operating expenses through FY 2011-12. In addition, Senate Bill 11-209 appropriated \$20,000 to the department for legal expenses related to the lawsuit in FY 2011-12. Should the Direct Marketing Association terminate its lawsuit against the department as a result of this bill, these expenditures need not occur.

<b>Cost Components</b>	<b>FY 2011-12</b>	<b>FY 2012-13</b>
Personal Services		
Reduction	(\$20,974)	(\$20,974)
<i>Conditional</i> Reduction*	(30,982)	
FTE		
Reduction	(0.5)	(0.5)
<i>Conditional</i> Reduction*	(0.5)	
Operating Expenses and Capital Outlay		
Reduction	(475)	(475)
<i>Conditional</i> Reduction*	(475)	
Legal Services - <i>Conditional</i> Reduction*	(20,000)	
<b>TOTAL</b>	<b>(\$72,906)</b>	<b>(\$21,449)</b>
<b>FTE</b>	<b>(1.0)</b>	<b>(0.5)</b>

\* *These expenditure savings are conditional, predicated on the Direct Marketing Lawsuit terminating its lawsuit against the Department of Revenue.*

**Local Government Impact**

House Bill 11-1318 will result in an undetermined reduction in revenue for all local government entities that collect a sales tax because online retailers that are members of a controlled group of corporations collect local sales tax in addition to state sales tax. Special districts will have an undetermined revenue loss because they will receive less revenue from the use tax.

**State Appropriations**

Depending on whether or not the Direct Marketing Association terminates their lawsuit as a result of this bill, this fiscal note indicates the following:

- If the lawsuit is terminated, General Fund appropriations to the Department of Revenue should decrease by \$72,906 and 1.0 FTE in FY 2011-12.
- If the lawsuit is *not* terminated, General Fund appropriations to the Department of Revenue should decrease by \$21,449 and 0.5 FTE in FY 2011-12.

**Departments Contacted**

Revenue