

New Hampshire Challenges Massachusetts's Use Tax Collection

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On April 8 the New Hampshire Senate unanimously passed SB 5, legislation designed to protect New Hampshire retailers from burdensome use tax collection requirements imposed by other states. The action is the newest development in a brewing conflict over Massachusetts's assertion of use tax collection liability against businesses with locations in New Hampshire.

A Response to *Town Fair Tire*

SB 5 was drafted in response to the position taken by the Massachusetts Department of Revenue in *Town Fair Tire Centers, Inc. v. Commissioner of Revenue*, Docket No. C280606, Appellate Tax Board (June 9, 2008). (For the decision, see *Doc 2008-12879* or *2008 STT 114-16*.)

In *Town Fair Tire*, the DOR imposed use tax collection liability on a retailer and installer of auto tires for sales made and delivered at stores located in New Hampshire. The DOR did not produce any direct evidence that the tires were actually used in Massachusetts by Massachusetts residents. Instead, the DOR relied on an inference drawn from a sample of sales invoices that customers having a Massachusetts address or phone number would actually use the tires in the state. The DOR further assumed that none of those customers would pay their use tax, and that the vendor should have known that they would use the tires in Massachusetts.

Having cobbled together that chain of inferences for this limited sample (with no direct evidence of actual use in Massachusetts), the DOR delivered the coup de grace by asserting use tax collection liability on a portion of *Town Fair Tire*'s total sales made and delivered in New Hampshire.

The Massachusetts Appellate Tax Board upheld the DOR's determination, and *Town Fair Tire* has

appealed to the Massachusetts Supreme Judicial Court. Oral arguments have been scheduled for May 7.

Reasons for SB 5

Town Fair Tire has caused an uproar in New Hampshire. Gov. John Lynch (D) supported a legislative response, saying, "I am greatly disturbed that Massachusetts has ordered a retail store in New Hampshire to collect and remit an out-of-state use tax on certain over-the-counter sales at the store's New Hampshire locations. We should not allow Massachusetts to turn New Hampshire businesses into tax agents for Massachusetts."

From the viewpoint of New Hampshire's officials, the DOR's imposition of use tax collection liability against *Town Fair Tire* represents an assault on New Hampshire's right to establish positive economic development policy. No one challenges that Massachusetts has the constitutional power to impose use tax collection duties on vendors that have physical presence in its own state, or that it may require vendors to collect and remit use tax in connection with out-of-state sales when the vendors actually deliver goods into Massachusetts.

The Massachusetts DOR's imposition of use tax collection liability against *Town Fair Tire* represents an assault on New Hampshire's right to establish positive economic development policy.

But it is quite another thing to impose use tax collection liability, as in *Town Fair Tire*, when a vendor completes every part of a sale and delivery of an item outside Massachusetts, and the vendor has no direct evidence that the customer actually used the purchased items in Massachusetts. Once untethered from a requirement for direct evidence of actual use within Massachusetts (such as delivery to

a Massachusetts address at the request of the customer), the enforcement of use tax collection liability becomes the effective equivalent of an arbitrary and discriminatory sales tax on the out-of-state vendor itself.

That threat of careening use tax collection obligations has a chilling impact on New Hampshire's ability to implement positive tax and business development policies. The DOR position places a New Hampshire business in the untenable position of having to guess whether a customer may use an item in Massachusetts. To illustrate, in *Town Fair Tire*, it would be possible, even reasonable, for the vendor to assume that the customer may be purchasing tires at a New Hampshire location because he was in the process of moving into the state. This reasonable assumption would not be contradicted by the fact that the customer still had a Massachusetts address or drivers license or had a phone number with a Massachusetts area code.

In retail contexts beyond tires, the guesswork becomes even more speculative. Will the customer use a purchased item at her home in Massachusetts or will she use it a lake home in New Hampshire? Under the DOR position, a vendor's failure to guess correctly risks exposure to an unexpected use tax liability for the business, or even personal liability for the business owner. Indeed, from New Hampshire's perspective, the risk of such an unprincipled imposition of use tax liability can reasonably be viewed as a threat to punish businesses that choose to open stores in New Hampshire.

The DOR's case is based on the assumption that Massachusetts residents will cheat on their use tax obligations and fail to properly report and pay their tax.

As Lynch said, the DOR's assertion of use tax collection liability in such cases is all the more vexing because the use tax is legally imposed on Massachusetts residents, not New Hampshire businesses. As one New Hampshire policymaker noted, Massachusetts's "dirty little secret" is that the DOR's case is based on the assumption that Massachusetts residents will cheat on their use tax obligations and fail to properly report and pay their tax. New Hampshire legislators are reasonably asking how it can possibly be good tax policy to impose a tax that a state's own tax agency presumes no individual will pay. That question is particularly troubling to New Hampshire officials who have established the business enterprise tax, which has been described as a more modern and administrable form of consumption tax that, unlike traditional retail sales taxes, can readily be applied to all business

transactions in a modern, mobile, electronic economy. (See Stanley Arnold and William Ardinger, "Top Ten Reasons Why New Hampshire's BET May Provide an Answer to State Tax Reform," *State Tax Notes*, Nov. 29, 2004, p. 583, *Doc 2004-20982*, or *2004 STT 229-16*.)

Highlights of SB 5

SB 5 must be understood within this context. In brief, the bill would prohibit New Hampshire businesses from disclosing private customer information in connection with another state's sales and use tax audit unless the state took steps to demonstrate that its sales and use tax regime does not impose unreasonable and burdensome collection responsibilities on out-of-state vendors.

The preamble to SB 5 asserts a "strong governmental interest in protecting the privacy of an individual's personal information that may be used to facilitate the sale of goods and services within this state." The bill asserts that the imposition of obligations to collect use tax on sales made and delivered within New Hampshire unlawfully discriminates against businesses selling items in New Hampshire because those businesses "are subject to potentially highly burdensome and arbitrary requirements to determine, in some manner, whether a customer will store, use or consume such items within such foreign state even before the customer has in fact stored, used or consumed the item within such foreign state."

SB 5 would prohibit in-state retailers from disclosing private customer information arising from a New Hampshire retail purchase transaction to any "foreign state" for purposes of enforcing the foreign state's collection of use tax, unless three conditions are satisfied, each targeted to describe a use tax collection process that is more balanced and less arbitrary. First, the foreign state must provide written notice to the New Hampshire Department of Revenue Administration (DRA) of its intent to collect a use tax on particular retail transactions (the notice of intent). Second, the foreign state must provide written confirmation to the retailer that it has provided the notice of intent to the DRA. Third, within 60 days after the provision notice of intent, the New Hampshire Department of Justice must provide the DRA with a legal determination that the foreign state's sales and use tax statute meets eight criteria. (A copy of the full text of SB 5 is located at <http://www.gencourt.state.nh.us/legislation/2009/SB0005.html>.)

Most sales and use tax statutes would satisfy most of these eight criteria. However, several of the criteria would likely require states to consider amendments to their sales and use tax statutes. For example, one of the criteria is that the statute must require residents to provide information to the New Hampshire retailer concerning their intent for use of

purchased goods, and allow the retailer to rely on that information. Another criterion would require the foreign state to implement a rigorous annual reporting obligation on its residents regarding their use tax liability.

Conclusion

New Hampshire legislators are well aware that other states may object to SB 5 on the grounds that it purports to interfere with enforcement of their use tax collection requirement. However, New Hampshire legislators will respond that Massachusetts has effectively imposed an extraterritorial, discriminatory tax and administrative burden on New Hampshire commerce by imposing use tax collection liability even when sales are made and delivered entirely within New Hampshire, and the vendor has no direct evidence that the customer actually will use the item in Massachusetts.

The unanimous, bipartisan action of New Hampshire's Democrat-controlled Senate should provide Massachusetts officials with a wake-up call that there must be practical and reasonable, if not legal, limits to the DOR's assertion of administrative duties on out-of-state vendors to collect use tax on transactions that take place entirely outside Massachusetts. We hope that the Massachusetts Supreme Judicial Court will take judicial notice of the brewing jurisdictional conflict and instruct the DOR to retether its use tax enforcement activities to a requirement that there must be direct evidence of actual use within Massachusetts. Indeed, one might even hope that the court would direct the DOR to conduct more rigorous audits of the state's own residents, because they are indeed the persons who are legally liable for the use tax. ☆