

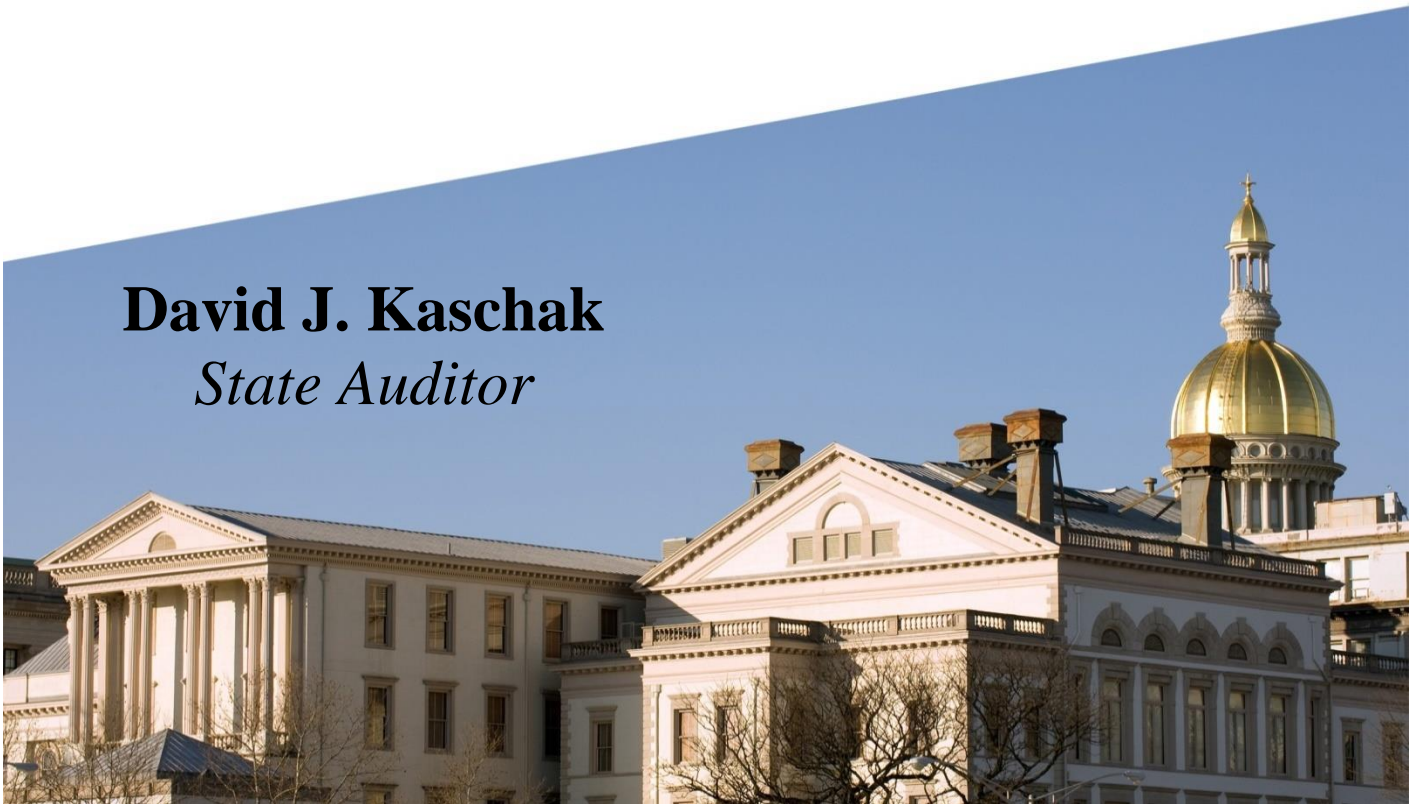


New Jersey Legislature
★ *Office of* LEGISLATIVE SERVICES ★
OFFICE OF THE STATE AUDITOR

Department of the Treasury
Division of Taxation
Remote Sales Tax

July 1, 2021 to March 31, 2024

David J. Kaschak
State Auditor



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Enclosed is our report on the audit of the Department of the Treasury, Division of Taxation, Remote Sales Tax for the period of July 1, 2021 to March 31, 2024. If you would like a personal briefing, please call me at (609) 847-3470.

A handwritten signature in black ink that reads "David J. Kaschak".

David J. Kaschak
State Auditor
July 16, 2024

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Scope

We have completed an audit of the Department of the Treasury, Division of Taxation (division), Remote Sales Tax for the period July 1, 2021 to March 31, 2024. Our audit included reviewing the monitoring activities performed by the division and determining compliance with the remote sales tax law.

The mission of the division is to administer the state's tax laws uniformly, equitably, and efficiently to maximize state revenues to support public services and to ensure that voluntary compliance within the taxing statutes is achieved without being an impediment to economic growth. The division is comprised of seven branches that are responsible for the administration, enforcement, and collection of 42 individual and business tax types in New Jersey.

Objectives

The objective of our audit was to determine whether the division's monitoring activities were adequate to ensure compliance with applicable state laws and regulations pertaining to remote sales tax.

This audit was conducted pursuant to the State Auditor's responsibilities as set forth in Article VII, Section I, Paragraph 6 of the State Constitution and Title 52 of the New Jersey Statutes.

Methodology

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

In preparation for our audit, we studied legislation, the administrative code, and technical bulletins and policies of the division. We also studied the Streamlined Sales Tax Agreement and best practices published by the Streamlined Sales Tax Governing Board, published reports by the Multistate Tax Commission and the Federation of Tax Administrators, other states' legislation and their audit reports relating to remote sales tax, and the Supreme Court's Wayfair decision. Provisions we considered significant were documented, and compliance with those requirements was verified by interview and analysis. We also interviewed division personnel to obtain an understanding of the internal controls. In order to achieve our objectives, we performed various comparisons and interviews as we deemed necessary.

Data was not used to materially support our findings, conclusions, or recommendations. As a result, a data reliability assessment was not completed for this audit.

Conclusions

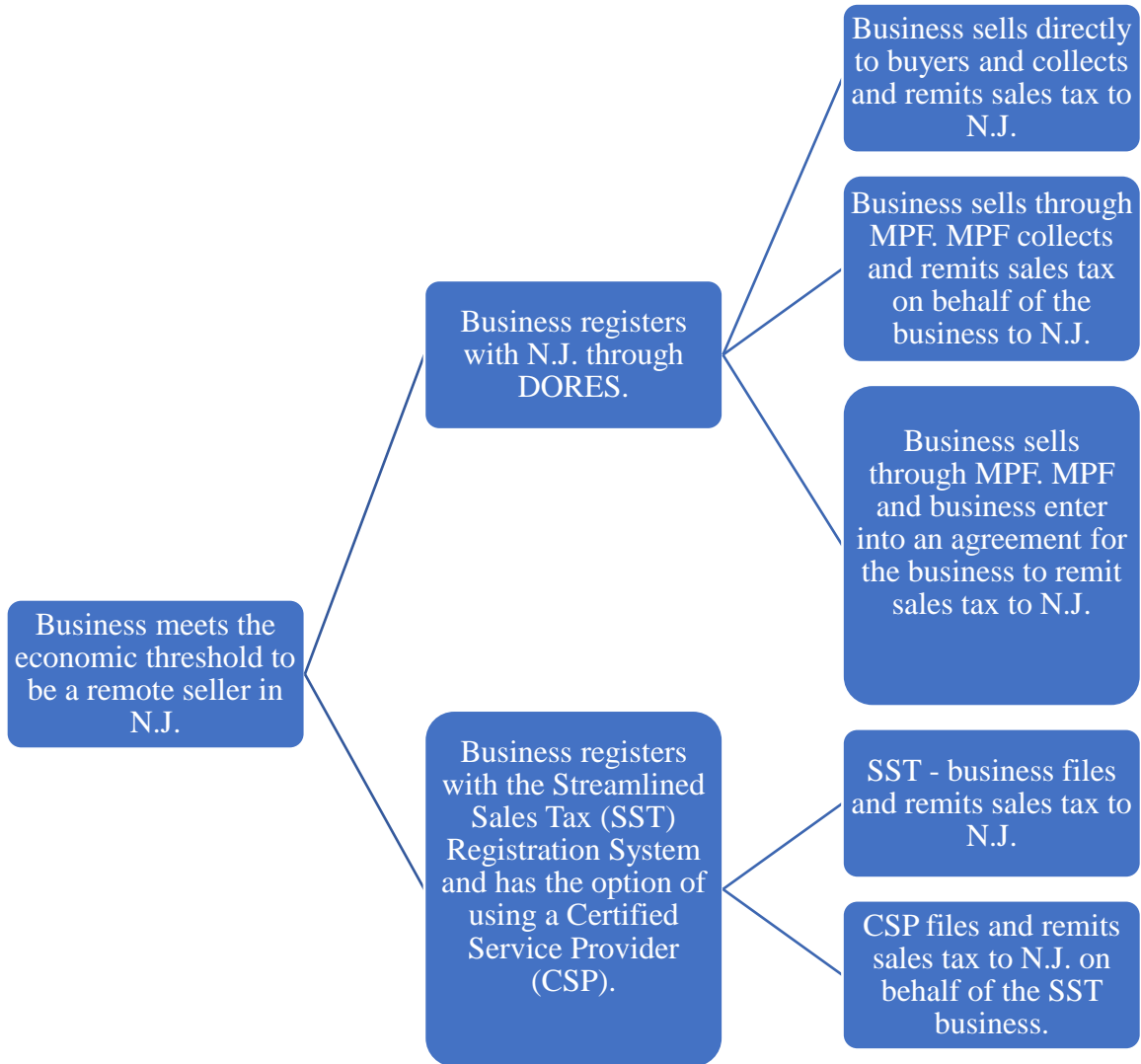
We found the division's monitoring activities were adequate to ensure compliance with applicable state laws and regulations pertaining to remote sales tax. However, in making these determinations, we found a best practice regarding the transactional nexus for remote sellers has not been implemented, weaknesses in taxpayer account recordkeeping, and United States Customs data is not being utilized to identify potentially noncompliant taxpayers. Additionally, we made observations concerning the division's ability to identify the total number of remote sellers in the state and the allowance of agreements between marketplace facilitators and marketplace sellers.

Background

On June 21, 2018, the Supreme Court of the United States ruled in the case of *South Dakota v. Wayfair, Inc.* that states may charge tax on purchases made from out-of-state sellers that do not have a physical presence in the taxing state. Based on the ruling, New Jersey supplemented the 1966 "Sales and Use Tax Act." Effective November 1, 2018, P.L.2018, c. 132 (law) requires sales tax to be collected and remitted from remote sellers that have an economic nexus in New Jersey, which is established when a business reaches sales revenue of \$100,000 or at least 200 separate transactions in the current or prior calendar year. Remote sellers registering directly with New Jersey are required to register with the Division of Revenue and Enterprise Services (DORES) and collect and remit sales tax to the Division of Taxation. Registration information is recorded into the division's TAXNET system, which is a compilation of mainframe data systems for taxpayer information. The law also states that marketplace facilitators (MPF) must collect and remit sales tax on the sales they facilitate unless the MPF and the seller enter into an agreement regarding the collection and remittance of sales tax. Examples of notable MPFs are: Amazon, eBay, and Etsy.

New Jersey became a full member of the Streamlined Sales Tax Governing Board (board) on October 1, 2005, thereby allowing sellers to register through the Streamlined Sales Tax (SST) Registration System. The board has agreements with 24 states. The goal of the SST is to reduce the burden of tax compliance and provide uniformity of tax base definitions. A business can outsource most of its sales tax administration by contracting with a Certified Service Provider (CSP), which is an agent certified under the SST Agreement.

The following chart illustrates the relationship between registration and the remittance of sales tax.



Transactional Nexus for Remote Sellers

New Jersey has not implemented the SST best practice of eliminating the transactional nexus threshold to relieve the burden on small businesses.

The New Jersey sales tax law was amended effective November 1, 2018 requiring sales tax to be collected and remitted from remote sellers that have an economic nexus in New Jersey, which is established when a business reaches sales revenue of \$100,000 from the delivery of tangible personal property, specified digital products, or taxable services or at least 200 separate transactions sold into the state in the current or prior calendar year. New Jersey became a full member of the SST board in 2005. The board adopted a best practice in May 2023 recommending states remove the number of transactions from the economic nexus calculation for remote sellers. However, New Jersey has not eliminated the 200-transaction nexus threshold as recommended by the board. We found 25 of the states that collect sales tax calculate their remote seller nexus strictly using a monetary economic threshold. Twelve of these states originally had a transactional nexus in their sales tax laws but have since eliminated the requirement in order to simplify sales tax compliance and lessen the burden on small businesses. Another state plans to eliminate the transactional nexus as of July 1, 2024.

Part of the mission of the division is to ensure compliance within the taxing statutes is achieved without being an impediment to economic growth. Low-dollar, high-volume sellers may be unduly burdened by the 200-transaction threshold, while high-dollar, low-volume sellers may be relieved from this burden. For example, a business selling one item into New Jersey for \$97,000 would not be required to remit sales tax. However, a business that has 250 separate sales transactions into New Jersey totaling \$1,250 would be required to remit sales tax. During the June 14, 2022 U.S. Senate Finance Committee hearing on Sales Tax Post-Wayfair, small business owners and industry professionals testified to the high cost of compliance with remote sales tax laws. Two individuals testified that they incur annual expenses of close to \$50,000 in order to be in compliance with the law. Another individual testified that they have worked with clients who sometimes file monthly returns with remittances of less than \$1.00 in tax, while it can cost between \$25 and \$50 per return to file using a paid preparer. The compliance burden on low-dollar, high-volume businesses could disincentivize businesses to sell into New Jersey.

Recommendation

The division should seek legislative changes that mirror the SST board's best practice to eliminate the transactional nexus for remote sellers.



Taxpayer Accounts

There is no historical record within TAXNET documenting changes made at the request of the taxpayer through the SST board.

The board sends an email to each state's SST representative where the taxpayer is registered notifying them to update/modify taxpayer's account information. The TAXNET system serves as the division's primary computer system for taxpayer information, such as the taxpayer profile, case tracking, check processing and accounting, and filing and payment history. The division has no policy requiring the state's SST representative to enter a case note in TAXNET to justify the changes made to the taxpayer's account. Additionally, the division does not maintain a database documenting the changes that were made, along with who made the changes. The lack of a historical record allows for the possibility of improper or unauthorized modifications to be made to a taxpayer's account.

Recommendation

The division should ensure any changes to a taxpayer's account based on communication from the SST board are properly documented in the TAXNET system. In addition, the division should develop a process to maintain and track communications received from the SST board detailing changes.



United States Customs Data Match

The division does not use data from the United States Custom match to identify potential remote sales tax revenue.

New Jersey entered into a Memorandum of Understanding (MOU) with the United States Department of the Treasury, United States Customs Service (Customs) in June 1995 to develop an interface to accommodate data on imports of tangible personal property with transactional nexus in the state. Data is provided to the division quarterly for the purpose of tax administration. The MOU is intended to be in force until terminated.

We researched other states and noted an audit report by the Tennessee Comptroller of the Treasury on the Tennessee Department of Revenue (department) published in September 2021. The report documented the success of the department using Customs data to identify potentially noncompliant remote sellers that met nexus thresholds. The data match performed by Tennessee resulted in 200-300 audit leads each quarter since implementation and additional tax revenue of \$796,000 and \$1.6 million for fiscal years 2019 and 2020, respectively.

The division performed a Customs match with New Jersey tax records for approximately four years starting in 2006. However, the division has not used Customs data to identify noncompliant

remote sellers meeting nexus thresholds since the inception of the remote sales tax law. The division may be losing sales tax revenue on purchases delivered into New Jersey via internet sales.

Recommendation

We recommend the division use Customs data to identify potentially noncompliant remote sellers.



Observations

Identification of Remote Sellers

The division cannot determine how much revenue is generated from remote sales tax.

Although businesses have the option to register as a “remote seller only” during the registration process, there is no requirement for a business to identify as a remote seller per the law, division policies, or the sales tax return. Businesses that meet the remote seller nexus do not always accurately identify their business type during initial registration or when updating their existing registration. For example, a business that is a remote seller but does not identify as such will not be identified as a remote seller in TAXNET. Conversely, a business that started and registered as a remote seller but subsequently obtained physical presence in New Jersey without changing their business entity type will be identified incorrectly as a remote seller in TAXNET. The division agrees the remote seller population within TAXNET cannot be identified, and therefore, the sales tax revenue derived from the legislation cannot be quantified.

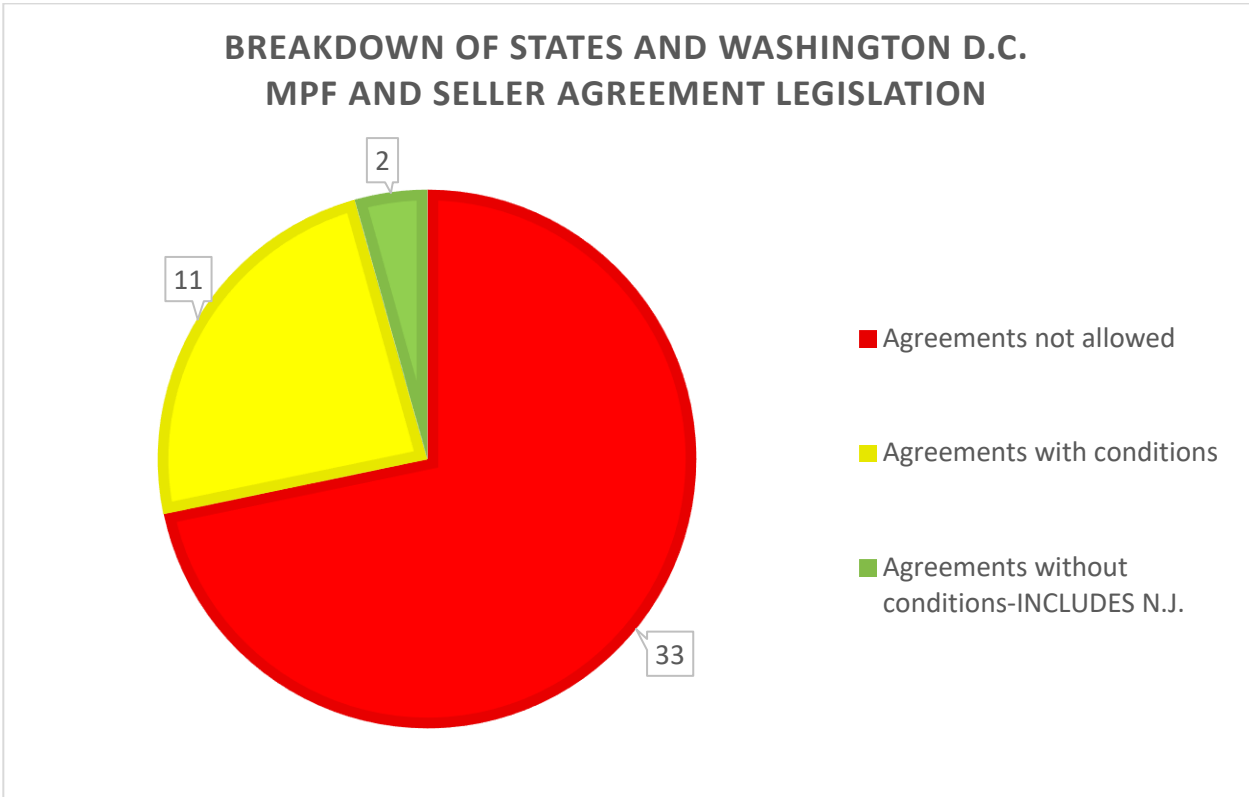
Marketplace Facilitator and Marketplace Seller Agreements

A lack of any requirements for necessary conditions to be met or disclosure of agreements between MPFs and marketplace sellers regarding sales tax remittance responsibilities could impact collections and enforcement.

MPFs facilitate retail sales of tangible personal property, specified digital products, or taxable services and typically manage sales tax collection and remittance on behalf of the marketplace sellers (sellers) who sell on their platforms. Centralizing the sales tax responsibility makes it simpler for states to ensure sales tax is properly remitted and reduces the cost of ensuring compliance compared to managing many small taxpayers.

P.L.2018, c. 132, effective November 1, 2018, requires MPFs to collect and remit sales tax to the division for the facilitated sales. However, it also allows MPFs and sellers to enter into agreements with each other regarding the collection and remittance of sales tax. New Jersey is one of two states that does not require MPFs or sellers to meet any conditions prior to entering

into an agreement. The chart below shows the breakdown of MPF and seller agreement legislation for the 45 states and Washington, D.C. that have sales tax laws.



In January 2020, the National Conference of State Legislatures Executive Committee Taskforce on State and Local Taxation unanimously approved a model legislation proposal for MPF sales tax collection. The proposal outlines conditions under which MPFs and sellers can enter into an agreement regarding the collection and remittance of sales tax. The conditions include but are not limited to: annual United States gross sales over \$1 billion; the seller registering with the state's taxing authority; and the seller notifying the state taxing authority of the agreement. We noted that five states follow these criteria. Additionally, we noted six other states also require the MPFs and sellers to meet certain conditions prior to the allowance of agreements.

Impact on State Revenue and Auditing Concerns

The division is unaware which businesses should be remitting sales tax, possibly causing an underreporting of sales tax revenue to the state. During our review, we noted one MPF published the MPF and seller agreement policy on its website. This MPF collects the sales tax and forwards it to the seller, and the seller bears the responsibility to remit the sales tax to the state. The division cannot make inquiries in these situations because they are not made aware of these agreements, which leads to the possibility of the seller not forwarding the sales tax to the division.

Additionally, this creates a logistical hardship for the division's auditors by necessitating visits to numerous locations, investing more time and resources, and prolonging the duration of the audit engagement. Not requiring disclosure of agreements also places a burden on auditors because they will not discover the existence of any agreements until the start of an audit, making audit planning and budgeting difficult. Our discussions with division auditors disclosed that MPFs have not been cooperative with providing a listing of agreements when requested.





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July 2, 2024

Brian Klingele, Assistant State Auditor
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Dear Mr. Klingele:

We appreciate the opportunity to respond to the recommendations contained in the audit report for the Department of the Treasury, Division of Taxation, Remote Sales Tax for the period July 1, 2021 through March 31, 2024.

The following summary highlights our efforts to date and the actions we plan to undertake this calendar year.

Transactional Nexus for Remote Sellers

Recommendation: The division should seek legislative changes that mirror the SST (Streamlined Sales Tax) board's best practice to eliminate the transactional nexus for remote sellers.

Response: Taxation agrees, and recommended this change as part of our "Tax policy" recommendations for the FY2025 budget period. While this change has not been posted in any proposed legislation, the agency will continue to push for this recommended change.

Taxpayer Accounts

Recommendation: The division should ensure any changes to a taxpayer's account based on communication from the SST board are properly documented in the TAXNET system. In addition, the division should develop a process to maintain and track communications received from the SST board detailing changes.

Response: The limitations of Taxation's legacy mainframe technology doesn't allow for proper recordkeeping and documenting where a change was requested, and by whom. Taxation will create a database to capture all requested changes while we work through implementation of the STAR, tax and revenue integrated tax system. This modernized platform will allow the capture of any


service request, with details as to who, when, why any change was requested. Implementation of STAR as it relates to sales tax and remote sellers will launch in early 2025.

United States Customs Data Match

Recommendation: We recommend the division use Customs data to identify potentially noncompliant remote sellers.

Response Taxation previously used customs data in the early 2000's with limited results, with the Wayfair decision, and the greater impact of remote transactions, Taxation will engage with the IRS on receiving and utilizing the customs data for future projects.

Sincerely,



Marita R. Sciarrotta
Acting Director
Division of Taxation

C: State Treasurer, Elizabeth Maher Muoio