

State Tax Amnesties: Forgiveness Is Divine — and Possibly Profitable

by LeAnn Luna, Michael Brown, Katrina Mantzke, Ralph B. Tower, and Lorraine Wright

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I. Introduction

Alexander Pope said, "To err is human; to forgive divine." Over the past 25 years, tax authorities have implemented state tax amnesty programs that forgive criminal and monetary tax penalties of noncompliant taxpayers. With the increasing frequency of state amnesty programs, policymakers should consider if those programs are effective and keep delinquent taxpayers on the tax rolls. John F. Kennedy once said, "Forgive your enemies, but never forget their names." Forgiveness may be divine, but tax authorities should never forget noncompliant taxpayers' names.

State tax amnesty programs began in 1982 when Arizona offered penalty and interest relief to any taxpayer that voluntarily filed one or more overdue tax returns during the two-month amnesty period. That initial effort enjoyed only modest success (\$6 million raised), but it set the stage for 83 general amnesty programs through July 2006 as well as other amnesties directed at targeted sets of taxpayers.¹ States justify those efforts in a variety of ways.

¹The Federation of Tax Administrators provides a summary of those general amnesties at <http://www.taxadmin.org/>

(Footnote continued in next column.)

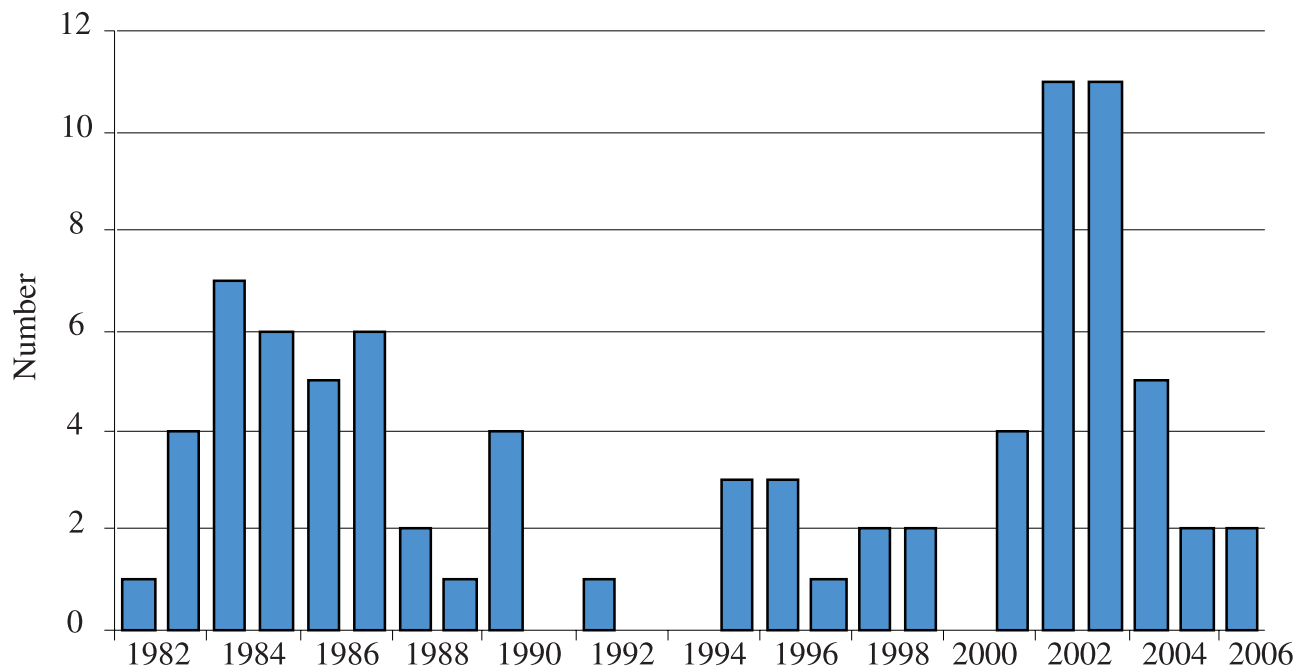
One common reason given is that revenue departments are unable to identify all delinquent taxpayers, and an amnesty is a relatively easy way to entice those not currently filing tax returns to voluntarily pay their taxes. In addition to the initial short-term revenue increase, the hope is that the taxpayers coming forward will remain on the tax rolls, increasing future tax receipts as well.

Over the past 25 years, 26 states have offered more than one amnesty, and 6 states (Connecticut, Louisiana, Massachusetts, Missouri, New Jersey, and New York) conducted more than two general amnesty programs.

Early amnesties covered most taxes and types of taxpayers. In recent years, states have targeted amnesties at specific subsets of taxpayers. Likewise, states have rolled out amnesties in conjunction with major changes in tax administration, such as extended statutes of limitation, increased penalties, or new reporting requirements. As discussed more fully below, seven states have offered targeted amnesty to taxpayers that will be affected by substantial changes in audit and enforcement of tax shelter activities. States have also offered almost complete amnesty for vendors that agree to collect sales tax on future sales into states that are full members of the Streamlined Sales Tax Project.

fta/rate/amnesty1.html. Rhode Island offered the most recent amnesty program, which began on July 15 and will end on September 30, and it will cover any tax collected by the Rhode Island tax administrator. With some exceptions noted, most of those amnesties cover all the major types of taxes. This list does not include the tax shelter amnesties or the streamlined sales tax amnesty, which are discussed in more detail below.

Figure 1
Number of Amnesties by Year



Source: Federation of Tax Administrators, http://www.taxadmin.org/fta/rate/amnesty_1.html.

This report examines state tax amnesties since their introduction over two decades ago. We identify trends in the programs and discuss some of the issues and trade-offs that states should consider before offering future amnesties. Six states have offered three or more general amnesties since 1982. The first section of the report discusses the general amnesties for those six states to illustrate how general amnesties have changed over time. The second section of the paper discusses specific amnesties directed at tax shelter participants and remote vendors. We conclude with a discussion of the trends and a general discussion of the trade-offs inherent in offering relief to those that have not lived up to their tax obligations.

II. Six States' Experience With General Amnesties

Most states have granted amnesty sparingly; others have offered it repeatedly. Over the past 25 years, 26 states have offered more than one amnesty, and 6 states (Connecticut, Louisiana, Massachusetts, Missouri, New Jersey, and New York) conducted more than two general amnesty programs.

This section focuses on key elements of those six states' general amnesty programs, how they have changed over time, and the insights they offer into current amnesty trends.² We specifically address taxes covered, time period between amnesties, taxes collected, relief available to taxpayers, and any other unique features. Refer to Table 1, p. 501, for a summary.

Authority

In the beginning, there was uncertainty about whether the executive branch through its administrative powers (for example, revenue departments) or the legislative branch of government should grant taxpayers amnesty. For example, no legislative approval was required for Missouri's 1983 program. The authority arose from preexisting administrative powers that permitted the waiver of tax penalties. However, the other five states felt that legislative participation was essential to the process. Missouri

²See also Mikesell (1986).

subsequently agreed, and authorization by statute quickly became the prevailing practice.

Reporting Periods

Amnesty reporting periods varied greatly from a low of 58 days for New Jersey's 2002 campaign to a high of 153 days for Missouri's 2003 amnesty. The average period was about three months, although the recent trend has been for shorter enrollment periods. For more recent programs, the average amnesty period has declined by more than a week, to 82.8 days for the most recent campaign compared with 95.2 for its predecessor. Also, 16 of 19 programs began between August and December, perhaps to take advantage of the lighter seasonal workload for tax administrators and professionals.

There has been little consistency in the interval between campaigns, averaging approximately 5.8 years, but the range was significant. Massachusetts's 2003 amnesty began less than a month after the close of the 2002 program. However, the time span between both Massachusetts's 1984 and 2002 campaigns and Missouri's 1983 and 2002 campaigns was nearly 19 years. The recession and budget crises of 2001 to 2003 and the need for a short-term revenue increase may have been the motivation for all six states in our analysis to undertake another round of amnesties. Consequently, the average time interval between campaigns dropped from 10.3 years to 4.6 years for the most recent amnesties. In fact, 35 of the 83 total general amnesties offered since 1982 occurred during the current decade, most of them during the budget crisis years (see Figure 1).

Collections

Invariably, state officials report unqualified success in securing much-needed tax revenues as a result of their amnesties. The available evidence indicates that amnesty programs do produce a short-term increase in tax revenue; however, the long-term effects are less certain. Data collection techniques and revenue definitions vary by jurisdiction and are inconsistent. Some states, for example, include receipts from new taxpayers, including new residents, in the amnesty total. Others include collections on existing accounts receivable (Duncan and Fox, 2006). In Christian et al.'s 2002 study of Michigan's income tax amnesty, two-thirds of the new filers were known to the Department of Treasury before the amnesty, and the amnesty raised modest new revenues — approximately 0.1 percent of the state's personal income.

Also, it is difficult to separate the amnesty effects from the coercive effects of the new enforcement provisions that so often follow amnesty programs. Clearly, some of the amnesty collections probably would have occurred without the amnesty program, and the states lose money by forgiving the penalties and interest that would have otherwise applied.

The published results discourage detailed comparisons, but they do show considerable variation in the amount of money raised by individual campaigns. States' efforts have become more sophisticated (for example, with improved publicity efforts), and states have been successfully consistent in raising short-term revenues. Louisiana collected approximately \$173 million during its latest amnesty program/campaign in 2001. Connecticut collected \$109 million in 2002. States such as Missouri and Massachusetts that offered two amnesty programs within a short time span collected significant nominal dollars, but that strategy has drawbacks. Revenues from the second campaign fell far short of the first, and there was widespread criticism from law-abiding taxpayers that frequent amnesty programs unfairly reward tax evaders.

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Research suggests that multiple amnesty programs will lead to declining revenues. The danger of multiple amnesties is that taxpayers might be more willing to avoid filing if they think an amnesty will eventually bail them out of penalties before they get caught by audit. There is also a legitimate fear that taxpayers may opt to delay tax payments with the expectation that another amnesty would soon be offered (Duncan and Fox, 2006). Christian et al. (2002) found that Michigan individuals had lower filing rates in subsequent years when compared with the year the amnesty was effective. Fox et al. (2006) show that taxpayers did anticipate future amnesties because collections were enhanced by amnesties during the early time periods but declined in the latter time periods. The best amnesties may be the ones that are offered only once or have long periods of time in between amnesties.

Eligible Liabilities and Taxpayer Benefits

Not all general amnesties cover every tax administered by the state. For example, in 2002 New Jersey offered amnesty for "state taxes administered and collected by the Division of Taxation." In contrast, New York listed 19 specific taxes in its 2002 Technical Service Bulletin that were covered under the program along with six that were not. Most programs cover income taxes for almost all taxpayers but frequently exclude specific business taxes such as

those on utilities and fuel. As with most privileges granted by the state, exceptions limit the privilege's scope. States have historically restricted the amnesty incentives by narrowing the applicable time period and by rejecting some types of taxpayers. Usually amnesty applicants can request relief for any past due return, but there have been exceptions. For instance, in its most recent campaign, New Jersey has excluded years covered by previous amnesty offers. The Legislature reasoned that previous amnesty terms were generous and that further leniency for those years was unwarranted.

One of amnesty's basic tenets has been the refusal to accept requests from taxpayers currently under criminal investigation or prosecution because a blanket amnesty could reward taxpayers engaged in the most egregious and obviously corrupt activities. Massachusetts took that position in each of its three campaigns. Other states have limited the potential amnesty beneficiaries even further. For example, Connecticut refused amnesty to all taxpayers under audit or criminal investigation, as well as those with pending civil or criminal litigation for fraud or for failure to file or pay tax. Louisiana adopted similar provisions and initially limited relief to individuals and businesses with revenues of less than \$1 million. To expand collection potential, that feature was subsequently eliminated.

Payment Conditions

Another central tenet of general amnesty is immediate payment of the taxes that are due. All of the programs required direct payment either within the grace period or through short-term installments. States' positions differed on other liabilities arising from the amnesty, such as interest, penalties, and fees. Louisiana's requirements changed over time, initially demanding remittance of only the tax owed but eventually requiring payment of both taxes and fees. Massachusetts demanded payment of the tax and applicable interest. New Jersey had the most generous terms of the amnesty programs examined. Its 1996 and 2002 amnesty programs excused the taxpayer from all interest and collection costs and waived civil and criminal penalties. Other states have been far less generous. For example, Connecticut's 1996 and 2002 programs promised waiver of penalties, protection from prosecution, and a *reduced* interest rate. Massachusetts adopted an even more conservative approach. The 2002 and 2003 amnesty incentives were limited to unpaid penalties and forgoing criminal proceedings.

After their first amnesty, many of the states made efforts to liberalize the incentives in the hope of increasing receipts. However, public reaction was mixed. Taxpayer advocates questioned the fairness of amnesty provisions that relieved tax scofflaws from conventional payment requirements. Law-abiding taxpayers believed they were disadvantaged

by paying on time if others could avoid all interest and penalties. Lately, states have begun to limit the incentives to penalties only or to forgiving only a portion of the interest. New Jersey's response to taxpayers who chose not to take advantage of the amnesty was to impose an additional 5 percent penalty on unpaid back taxes and to strengthen provisions for seizure of property.

Publicity

Promotional strategies for amnesty programs have changed significantly over the years. For the initial programs, state officials simply sent out press releases that detailed "get tough" policies along with the amnesty benefits. Revenue departments contributed by sending payment notices to known delinquents. Massachusetts's 1983-1984 campaign, led by then-Gov. Michael Dukakis, drew national attention and helped bring about acceptance of amnesties. States then sought to improve revenue yields by expanding media coverage and streamlining collection procedures.

For its 1987 program, New Jersey adopted the theme "Time is Running Out" and supported it with a comprehensive advertising strategy that included two television commercials broadcast over the state's main broadcast channels. The state's Division of Taxation set up a hot line and handled over 250,000 applications. The \$4 million legislative appropriation to fund the campaign yielded revenues of over \$186 million. Since that time, states have added amnesty Web sites, increased the availability of technical information, created data warehouses for delinquent taxpayers, and shared information with other jurisdictions. Even small states have adopted such measures. For the 2002 campaign, the Connecticut legislature authorized over \$2 million for publicity, and the state revenue department developed a new computer system to track delinquents.

Litigation

One of the more controversial aspects of recent amnesties is that in return for penalty and interest relief, taxpayers frequently agree not to contest their tax liabilities or ask for refunds of taxes paid under the amnesty programs. Taxpayers are given a choice to agree to an adverse tax determination on an issue or give up the right to favorable amnesty treatment should the tax authorities decide against the position taken on the original return. As a result of that "plea bargain" approach, there has been very little litigation because by filing the returns, taxpayers agree to the liability.

Our study surveyed amnesty-related cases since 1982 for the six states. The results indicated that the vast majority of the litigation (40 of 50 cases) occurred in New York. Thirty-three arose from the first campaign (1985-1986), four from 1996-1997 and three from 2002-2003 amnesties. The majority

Table 1.
Summary of Six States With Three or More General Amnesties

State and Amnesty Period	Length of Amnesty	Average Time Between Amnesties	Eligible Liabilities	Reduction in Interest Rate	Revenues (in millions)	Special Payment Conditions (other than all taxes and interest)
Connecticut 9/1/02-12/02/02	3 months	6.76 years	All individual and corporate taxes except international gasoline tax.	25% reduction	\$109	
Connecticut 9/1/95-11/30/95	3 months	4.76 years	All individual and corporate taxes except federal income tax and local property taxes.	Reduced the interest rate for some taxpayers.	\$46.2*	
Connecticut 9/1/90-11/30/90	3 months	N/A	Any unpaid state taxes.		\$54*	
Louisiana 9/1/01-10/30/01	2 months	2.83 years	All types, including individual income, sales, inheritance, and other business taxes.	100% reduction	\$173.1*	Must pay taxes and fees due by the end of the amnesty period.
Louisiana 10/1/98-12/31/98	3 months	10.8 years	All types of taxes but only for individuals and small businesses with <\$1 million in revenue if not previously contacted. Those who owe \$500 or less in tax and previously contacted.	50% reduction	\$1.3	
Louisiana 10/1/87-12/15/87	2 months	1.75 years	All types but only for individuals and small businesses with <\$1 million in revenue if not previously contacted.		\$0.279	
Louisiana 10/1/85-12/31/85	3 months	N/A	All types but only for individuals and small businesses with <\$1 million in revenue if not previously contacted.	50% reduction	\$1.2	Must pay taxes owed in 30 days.
Massachusetts 1/1/03-2/28/03	2 months	0.08 years	All types		\$46.9	Must file a request for amnesty.
Massachusetts 10/1/02-12/2/02	2 months	18.72 years	All types		\$96.1*	Must file a request for amnesty.
Massachusetts 10/1/783-1/1/784	3 months	N/A	All types		\$86.5*	Taxpayer must pay the tax and interest within the period.
Missouri 8/1/03-10/31/03	3 months	0.75 years	All types, including failure to file, understated liability, and accounts receivable.	100% reduction	\$20*	The taxpayer must apply for and pay the tax within the grace period. Possible collection fee of 25% of delinquent tax.

Table 1.
Summary of Six States With Three or More General Amnesties
(continued)

State and Amnesty Period	Length of Amnesty	Average Time Between Amnesties	Eligible Liabilities	Reduction in Interest Rate	Revenues (in millions)	Special Payment Conditions (other than all taxes and interest)
Missouri 8/01/02-10/31/02	3 months	18.76 years	Aviation fuel tax, bank franchise tax, cigarette tax, corporation franchise tax, corporation income tax, credit institutions tax, credit union tax, employer withholding tax, estate tax, fiduciary tax, individual income tax, marine sales tax, other tobacco products, property tax credit, sales tax, savings and loan tax, and vendor's use tax.	100% reduction	\$ 76.4*	The taxpayer must apply for and pay the tax within the grace period.
Missouri 9/1/83-10/31/83	2 months	N/A	All types, including failure to file and understated liability. Did not include accounts receivables.	No reduction	\$0.9	Pay tax and interest by the end of the program.
New Jersey 4/15/02-6/10/02	2 months	5.87 years	All types	100% reduction	\$ 276.9*	The taxpayer must remit a check, money order, or cashier's check. Payment must be during the formal amnesty period. 5% penalty and additional collection service fee at the conclusion of the amnesty period.
New Jersey 3/15/96-6/1/96	2½ months	8.29 years	All types	100% reduction	\$ 359*	Taxes paid are nonrefundable and must sign a waiver of the right to appeal any liability paid under amnesty. After amnesty, additional 5% penalty imposed on back taxes. Seizure of property.
New Jersey 9/10/87-12/1/87	2½ months	N/A	All types	Interest in excess of 9%.	\$ 186.5*	The taxpayer must pay the tax and interest within the grace period. No penalties must pay interest that is under 9%.
New York 11/18/02-1/31/03	2½ months	5.8 years	All types. Some corporate taxes limited to companies with <500 employees nationwide.	Offered a two-point drop in interest on back taxes.	\$ 582.7*	After the deadline interest rates on outstanding liabilities rose two percentage points over previous amnesty levels.

Table 1.
Summary of Six States With Three or More General Amnesties
(continued)

State and Amnesty Period	Length of Amnesty	Average Time Between Amnesties	Eligible Liabilities	Reduction in Interest Rate	Revenues (in millions)	Special Payment Conditions (other than all taxes and interest)
New York 11/1/96-1/31/97	3 months	10.76 years	All types		\$ 253.4*	Taxpayers must pay bill issued by the commissioner for the designated taxes and interest. Installment arrangements available.
New York 11/1/85-1/31/86	3 months	N/A	State and NYC personal income, state and local sales and use, highway use, state and NYC withholding, motor fuel, estate and gift, state and NYC unincorporated business and business corporation, petroleum business, oil company, transportation and transmission company, Yonkers income tax surcharge, and Yonkers nonresident earnings.		\$ 401.3*	Installment arrangements available.

*Includes accounts receivable.

(33) related to sales and use taxes, 9 to the personal income tax, and 1 to the corporate income tax. New York's long experience provides other states with a useful information source in dealing with new and complex issues. The other five states have encountered far less litigation, averaging less than two cases per jurisdiction. Given the large volume of amnesty applications and the wide diversity of issues involved, the findings are encouraging. The controversies have been settled without resorting to extensive legal proceedings. The result is reduced compliance costs for both taxpayers and the taxing authorities.

III. Specific Amnesties

Specific amnesty programs include both voluntary disclosure³ and voluntary compliance initiatives and generally target taxpayers in very specific situations or target a particular type of tax (for example, sales taxes). This section of the report focuses on two specific amnesty programs. First, we will discuss the SSTP amnesty that focuses on voluntary compliance for remote sellers. Second, we will discuss the tax shelter amnesties that have been legislated in seven states to target abusive tax shelter activities.

The Streamlined Sales Tax Project Amnesty Program

The Problem with Remote Sales

The SSTP had its genesis in early 2000 when a number of states came together to develop a simplified sales tax system in the United States. The primary motivation behind the SSTP was simple: the collection of tax revenues on sales by remote vendors.

Remote vendors are able to sell into a state without being present in the state by executing their transactions remotely (via mail-order, catalog, or Internet sales) and delivering their goods by common carrier or electronically. By conducting business in this way, remote vendors may not have sales tax nexus, or a physical presence, in some of the states in which they sell. Without sales tax nexus, they are not compelled by law to collect sales taxes

³Fifteen states have voluntary disclosure programs that allow taxpayers who have not been contacted by the state to file and pay specific back taxes. Those programs differ from the general amnesties because typically voluntary disclosure programs are not available to registered taxpayers — only taxpayers that should have been registered and filing within a state but have not done so yet (for example, an out-of-state business that had nexus but failed to file tax returns in the state). Also, those programs are ongoing but have a specified look-back period in which all back taxes must be paid in addition to registration and ongoing compliance. Nine programs allow individuals to participate, four include business taxes only, and three target specific business taxes.

for those states. The nexus determination might be clear for an online retailer with no related traditional storefronts in a state. However, for many of today's largest retailers (for example, Borders, Best Buy, Wal-Mart), the question can be somewhat murky. Borders Online, a sister corporation of brick-and-mortar Borders Books and Music with physical locations throughout California, claimed no nexus in California for its online sales. In 2005 a California appeals court ruled that Borders Online, through its association with its related stores, had enough physical presence to require the online operations to collect sales and use taxes on all sales in California.⁴ Borders Online now collects sales taxes on its sales to all but a handful of states.

Of course, the use tax exists to mitigate the problem of no sales tax being collected on a sale. However, most consumers are either unaware of their use tax filing requirements or have decided not to comply with them because the likelihood of being audited by a state is very small.⁵ Several states have added a line item on their individual income tax returns to report unpaid use taxes, but taxpayers still largely ignore their use tax obligations because of the minimal risk of audit.

The problem of lost tax revenues on remote sales has existed since the beginning of remote selling. The U.S. Supreme Court ruled in two different cases spanning four decades that remote vendors do not have nexus and therefore have no legal obligation to collect tax on behalf of the state.⁶ In upholding a bright-line physical presence nexus requirement in the latter case, the Supreme Court recognized one large obstacle — the complexity of the current piecemeal approach to sales taxation. Hundreds of taxing jurisdictions exist, with different definitions of taxable items and exempt items, and tax rates that vary from county to county and city to city. However, in its ruling, the Supreme Court also said, "Congress is now free to decide whether, when, and to what extent the States may burden interstate mail order concerns with a duty to collect use taxes." In the intervening years, however, Congress has not acted on the Supreme Court's mandate. In light of those rulings, the states decided to take a different approach to the problem of uncollected taxes on remote sales.

⁴*Borders Online LLC v. State Board of Equalization*, 29 Cal Rptr 3d 176, May 31, 2005. (For the California Court of Appeal's decision in *Borders Online*, see *Doc 2005-12108* or *2005 STT 107-8*.)

⁵See Nunez et al. (2005) and Manzi (2005) for detailed discussions regarding use tax collections.

⁶The first case was *National Bellas Hess v. Department of Revenue*, 386 U.S. 753 (1967) and the second case was *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

The Streamlined Sales Tax Project

A number of states, under the auspices of the SSTP, came together to build a better sales tax system, defined as one that simplified the collection and remittance of sales tax across the states and the hundreds of distinct local sales taxing jurisdictions. The SSTP goals include uniform definitions, rate simplification, uniform sourcing rules, simplified exemption certificate administration, uniform audit procedures, and ultimately, increased participation by remote sellers. The states' collective goal was to enable remote sellers to collect and remit the taxes due on their sales without significant compliance burdens. With the impediment of compliance removed, the states hope that many remote vendors will voluntarily collect and remit taxes on their sales into a state.

By October 1, 2005, the SSTP had the necessary critical mass of participating states to become operational.⁷ The multistate agreement that made the SSTP a reality is referred to as the Streamlined Sales and Use Tax Agreement (SSUTA). Full members are those states whose current laws are in compliance with the SSUTA.⁸ Associate members are those states who are not yet fully compliant with the SSUTA but are scheduled or expected to become compliant by January 1, 2008.⁹ In conjunction with becoming a viable program, the Simplified Sales Tax Governing Board decided to institute an amnesty program to encourage remote vendors to begin collecting and remitting taxes on sales into the member states.

Streamlined Sales and Use Tax Agreement Amnesty

Like other amnesties, the SSUTA amnesty provides a reprieve from some existing tax obligations.¹⁰ However, this amnesty has a number of features that are unique.¹¹ Participation in the SSUTA amnesty is an all-or-nothing proposition. To participate, vendors must register through the cen-

tral registration system for the SSUTA with all *full* member states and then collect and remit taxes on sales made into those states. Vendors can decide on a state-by-state basis whether to register, collect, and remit taxes for *associate* member states. However, once an associate member state becomes a full member state, participating vendors will be required to collect and remit taxes on sales made into those states as well.

The SSUTA amnesty is very broad in that it has no lookback for tax, penalties, or interest. In other words, for those vendors that register to collect and remit tax, their past is definitely in the past. This is of no consequence to vendors that truly have no nexus in any particular state. However, this can be a powerful incentive for other vendors to participate if their nexus status is at all questionable in one or more states, a status that includes many of the nation's largest retailers. The SSUTA amnesty has various expiration dates. The amnesty expires on September 30, 2006, for the original full member states. However, most of those states have extended their amnesty closing period to May 2007 for registrants that intend to use certified service providers. Vendors must register with each state and establish a fully functioning sales tax collection system by the extended deadline. To date, about 500 firms have registered for the SSUTA amnesty.¹²

For each associate member state, the amnesty period begins on the date it becomes an associate member, but expires 12 months from the date that the associate member state becomes a full member state of the SSUTA. The extended amnesty expiration date will apply in a similar fashion for observing states that later sign the SSUTA.

Vendors that participate in the amnesty are required to collect and remit taxes for a 36-month period following their registration with the states. While there is no requirement to continue after this 36-month period lapses, the implicit hope is that vendors will continue to collect and remit taxes since the start-up costs of compliance will be sunk costs at this point. Arguably, if vendors determine that the costs associated with continued compliance are significant and exceed any related benefits, they will cease to collect and remit sales taxes, absent congressional action requiring sales tax collection by remote vendors.

Other limitations associated with the SSUTA amnesty are similar to provisions of other amnesties. Amnesty is not available in states in which the vendor is already registered. Similarly, amnesty is not available in states in which a vendor is currently

⁷Several states have been unable to pass legislation to participate in the SSTP because the agreement requires sales to be sourced to the destination of the customer, and many states source in-state sales on an origin basis.

⁸The states that are full participating members of the SSTP are Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, New Jersey, North Carolina, North Dakota, Oklahoma, South Dakota, and West Virginia. West Virginia passed legislation to conform to the SSUTA, effective June 9, 2006.

⁹Associate members states are Arkansas, Nevada, Ohio, Tennessee, Utah, and Wyoming. The remaining states that impose a sales tax, other than Colorado, are observing states. Also, Rhode Island and Vermont each recently petitioned to become a member state.

¹⁰For additional information, see <http://www.streamlinedsalestax.org/>.

¹¹Also see Swain (2005).

¹²Many of those participating businesses already have nexus in a state offering amnesty; therefore, the business has nothing to lose — but choosing to participate does eliminate the risk of audit for all past years.

under audit. The SSUTA amnesty exists only for uncollected sales and use taxes on sales into the states. As such, it is not available for taxes that have already been collected and not yet remitted. Finally, the amnesty does not cover sales or use taxes owed by the participating business on purchases for its own use.

Considerations for Participating

As with any amnesty program, a taxpayer must weigh the pros and cons of participating. The primary consideration will likely be the nexus status of the vendor. In the simple case of a remote vendor with no related traditional retail outlets and no employees (that is, no possible nexus) in any of the full or associate member states, participating in the amnesty is pointless. Agreeing to collect sales tax from its customers simply drives up the effective after-tax cost of its products. At the other extreme, if the vendor has nexus, or might under audit be determined to have nexus in some or all of the participating states, the amnesty is a favorable proposition. Recent court victories by states asserting nexus for some large retailers provide an incentive for many retailers to consider this amnesty opportunity.

Another significant consideration of participating in the SSUTA amnesty is the hurdle of determining the correct tax, collecting it, and remitting it to the proper tax authority. Even with the simplifications mandated by the SSTP, the task remains daunting. States are currently considering options to assist remote sellers with the software solutions that will help them comply with the reporting requirements of the SSUTA. The agreement also finalized the process for certification of software so that businesses can in good faith rely on the specific vendor selected.

Finally, vendors should be aware that federal legislation has been proposed that would create a new nexus standard for SSUTA states. U.S. Sens. Michael B. Enzi, R-Wyo., and Byron L. Dorgan, D-N.D., introduced separate bills (S. 2152 and S. 2153) to Congress on December 21, 2005, that promoted the SSUTA and would allow states that meet some specific simplification agreements to join a multistate agreement requiring remote vendors (with no physical presence) to collect sales tax.¹³ This standard would be a departure from the historical standard upheld by the U.S. Supreme Court, as discussed earlier. By reducing the nexus threshold for participating states, this legislation would require remote vendors to collect and remit tax in states that participate in the SSUTA, excluding

¹³Those two bills also include items that are not in the SSUTA, including requirements to simplify telecommunication taxes.

from the requirement only very small businesses with minimal sales. To date, it is unclear how much momentum this bill has in Congress. Yet, given the SSUTA's shift from conceptual to operational status, this legislation bears watching.

Tax Shelter Voluntary Compliance Initiatives

Background

Although tax shelters are nothing new, they have received increased attention from tax authorities at both the federal and state levels since the late 1990s. The IRS led the way in combating abusive tax strategies by issuing a series of IRS notices regarding specific strategies such as the Bond Option Sales Strategies (BOSS) and son-of-BOSS. "Listed transactions" that the IRS considered abusive increased from 5 in 1998 to over 30 today. The IRS also expanded tax shelter disclosure requirements to specifically address listed transactions. Because most states use federal taxable income as a starting point or as an integral component on their own income tax returns, the abusive tax shelters targeted by the IRS have direct implications on state income tax revenues.

States have collectively taken several steps to try to curtail abusive transactions. One example is a special amnesty targeted at taxpayers who engaged in abusive transactions. As of this writing, seven states have established a voluntary compliance initiative (VCI) for taxpayers that have participated in potentially abusive tax avoidance transactions. Those taxpayers that came forward during the VCI generally were liable for the additional tax and interest, but all of the penalties were waived.¹⁴ After the VCI reporting period expired, taxpayers and promoters faced new or expanded tax shelter reporting requirements and harsher penalties. The hope was that taxpayers would voluntarily come forward and self-report abusive transactions to avoid the additional penalties that would apply if the abusive transactions were discovered during audit.

Both the states and taxpayers had powerful incentives to participate in VCIs. California, for example, knew that the statute of limitations would expire before audits could identify many of the taxpayers that had engaged in abusive transactions following the stock market boom years of 1999 and 2000. The VCI and the subsequent increase in penalties took some pressure off their audit staff at the cost of abating the existing penalties as part of the amnesty. Taxpayers faced large incentives as well. The new legislation often doubled the existing

¹⁴The exception is Connecticut's 2005 program — its second in recent years — which imposed a 10 percent negligence penalty on participants (versus a 75 percent penalty). To entice more participants, Arizona's program could waive some of the interest due.

statutes of limitation, leaving noncooperating taxpayers with the unpleasant option of participating now and paying only taxes and interest or risk years of uncertainty and penalties that might have doubled the amount ultimately owed. Further, it was also highly publicized that the states and the IRS were cooperating and were sharing the names of promoters and taxpayers that participated in abusive transactions.

California was the first state to enact a VCI in 2004, followed by Illinois and Connecticut. Arizona, New York, and Minnesota enacted programs in 2005, and Connecticut offered a second program in 2005. West Virginia's VCI program is the most recent, beginning in August 2006. The general structure of each of these programs is similar. However, the differences regarding the penalties and required disclosures following the amnesty period require a careful examination of each program. Refer to tables 2 (p. 509) and 3 (p. 510).

Eligible Taxpayers

For most programs, eligible taxpayers include individuals, corporations, partnerships, estates, trusts, and exempt organizations that have engaged in specific types of forbidden transactions discussed in more detail below. Connecticut's 2005 VCI is the only program that also offered penalty relief (up to 50 percent of gross income derived from selling tax shelters) to promoters of tax shelters that provide their complete investor list and fee schedule. For all states except Arizona, taxpayers may participate in the VCI if they filed a state income tax return using a tax shelter or did not file a tax return because participation in the tax shelter eliminated their tax liability.

Surprisingly, several states (New York, Arizona, and Connecticut) allowed taxpayers to participate in the VCI even if they were already under audit by the state or federal government. However, taxpayers in Illinois could not participate if they were already under state audit and a tax was assessed.¹⁵ New York, Minnesota, and West Virginia prevented participation if the taxpayer was party to a criminal investigation regarding underreporting or underpayment of tax, had been convicted of a crime relating to the tax, or was a party to pending litigation. Also, New York, California, and Minnesota did not permit participation if the taxpayer already participated in the offshore voluntary compliance initiative offered by the IRS and several states.

Taxpayers eligible to participate must have engaged in transactions designated by the state. In all cases, eligible taxpayers included those that en-

gaged in a listed transaction under IRC section 6011 and Treas. reg. section 1.6011-4(b)(2), regardless of whether the IRS had formally identified the transaction at the time the taxpayer entered into the transaction. However, in several states, the definition of eligible transactions was broader and also included any transactions that are devised for the principal purpose of avoiding federal income tax. Three states — California, New York, and Minnesota — also authorize state tax commissioners to designate other transactions as abusive.

How They Work

Every state with a VCI except Arizona and Connecticut provided two options for participating taxpayers: (1) voluntary compliance without appeal and (2) voluntary compliance with appeal. In general, if taxpayers forfeit their right to appeal, they cannot claim a refund or credit for the amounts paid that arose due to the tax avoidance transaction. Other amounts paid that are not attributable to tax avoidance are unaffected by the election. The state will not impose any existing penalties for the underreporting or underpayment of the additional tax or the new tax shelter penalties that generally took effect at the end of the amnesty period. Also, taxpayers avoid any civil or criminal prosecution regarding the use of the tax shelter.

If taxpayers choose the second option, voluntary compliance with the right to appeal, then taxpayers may be entitled to make a claim for refund or credit. Taxpayers will avoid the new tax shelter penalties and civil and criminal prosecution; however, they will remain subject to the late payment of tax and underpayment of tax penalties. Once the election is made, it is irrevocable, and the election is made for each year. California reported that 40 percent of its participants (482 taxpayers) elected to keep their appellate rights, and the state reported \$355 million in VCI revenues (nearly 25 percent of the total VCI collections).¹⁶

In all cases, taxpayers must concede 100 percent of the claimed artificial tax loss created by the abusive transaction, file an amended state income tax return, and pay any tax and interest due on the underpayment. In exchange for participation in the compliance initiative, the departments of revenue agreed to forgo civil penalties and the option of criminally prosecuting participants. Connecticut's second amnesty program in 2005, however, required participating taxpayers to pay a 10 percent negligence penalty in addition to the tax and interest due on the deficiency that resulted from the taxpayer's

¹⁵However, it is unclear if taxpayers can participate if the IRS has targeted them.

¹⁶See California 2004 Voluntary Compliance Initiative for Abusive Tax Shelters at http://www.ftb.ca.gov/law/tax_shelter/VCI_Final/Final_rpt.pdf for additional information.

participation in the tax shelter. However, a new 75 percent penalty for failure to disclose a listed transaction was avoided.

The Penalties

Like the IRS, most VCI states have taken a two-part approach to their revised penalty structures. The first step is to require both taxpayers and tax shelter promoters to disclose their participation in listed or reportable transactions. The American Jobs Creation Act of 2004 imposed a federal penalty of \$100,000 (individuals) or \$200,000 (for all other taxpayers) for failure to disclose participation in a listed transaction. Several states followed suit with their own flat rate nondisclosure penalties. For example, in California, the penalty is \$30,000/\$15,000 for failing to disclose a listed/reportable transaction. Promoters that are required to register a tax shelter are subject to penalties ranging from 50 percent to 75 percent of their gross income derived from promoting tax shelters if they fail to make the required disclosures.

Taxpayers and tax professionals need to read each state's disclosure law carefully, however, because the transactions that must be disclosed vary significantly from state to state. For example, California and New York have a very broad definition that includes transactions identified as listed or reportable at the federal level and any additional transactions identified by state tax authorities. Connecticut, on the other hand, does not require a separate state-level disclosure, but penalizes nondisclosure *at the federal level* of listed (not reportable) transactions.

The second step states took was to implement additional penalties.¹⁷ California found in its surveys with tax professionals that their existing penalty structure was not punitive enough to change taxpayer behavior.¹⁸ Therefore, California and several others implemented new penalties that apply if a taxpayer engages in many abusive tax avoidance transactions. Although the penalties vary significantly by state, Arizona and Connecticut now assess a 75 percent penalty on the improper tax reduction claimed as a result of the abusive transaction. Several states, including California, Illinois, and West Virginia, assess a penalty equal to 100 percent of the interest on any underpayment. Finally, several states significantly increased the statute of limitations to assess these new penalties. Most states doubled the period from three years to six years, while California doubled its statute of limitations from four years to eight years. The new statutes of

limitations keep open the stock market boom years of 1999 and 2000, when many of the abusive transactions took place.

Coordination With Other States and the IRS

Policymakers hope that the new disclosure requirements, harsher penalties on both promoters and taxpayers, and longer statutes of limitations will tilt the balance of risk away from abusive tax avoidance transactions. One other significant step toward that goal involves state and federal tax administrators and their efforts to efficiently share information whenever an abusive transaction is uncovered. For example, the Multistate Tax Commission recently formalized a disclosure program to deal with abusive tax shelters that will be launched during 2006.¹⁹ That program will work as a liaison between the states, the Federation of Tax Administrators, and the IRS by coordinating the dissemination of information and providing expertise regarding abusive tax shelters.

Also, all of the tax shelter amnesty states have signed a joint agreement to share information on abusive tax shelters with each other. States are developing tracking systems and databases to better identify users and promoters of tax shelters. Further, 47 states have signed the Abusive Tax Avoidance Transactions (ATAT) Memorandum of Understanding (MOU) with the IRS to share a database of types of schemes, investor and promoter lists, audit techniques, procedures, litigation efforts, and guidelines regarding abusive tax avoidance schemes.²⁰ The hope is that the MOU will enhance efficiency, reduce duplication of efforts, and maximize resources.

An example of the IRS's efforts to share information with the states regarding abusive tax shelters can be seen with the IRS son-of-BOSS initiative. The IRS projects that the settlement will raise \$3.5 billion in revenue (IR-2005-37, March 24, 2005). While complying with the IRS's settlement initiative, many taxpayers also amended their state tax returns. As a result, Arizona, Illinois, Maine, Maryland, Michigan, New York, Ohio, Utah, and Virginia report collecting more than \$23.5 million (combined from all states) from voluntary state tax return amendments through March 2005 (FS-2005-13). Further, California and New York pursued those transactions through their VCI and reported collections of \$132 million and \$45 million, respectively, through March 2005 (FS-2005-13).

¹⁹See Parker (2005).

²⁰Also, the District of Columbia, New York City, and the MTC have signed the agreement. The three states that have not signed the agreement are Mississippi, Nevada, and Wyoming.

¹⁷See Pakenham (2006) for a detailed discussion of state tax shelter penalties.

¹⁸See Ibele and Vasche (2006) for a detailed discussion of tax shelters and related legislation in California.

Table 2.
Tax Shelter Amnesties: General Information

	Arizona	California	Connecticut	Illinois	New York	Minnesota	West Virginia
Amnesty Period	Feb. 14, 2005 - Apr. 22, 2005	Jan. 1, 2004 - Apr. 15, 2004	June 16, 2004 - July 31, 2004, Oct. 1, 2005 - Dec. 31, 2005	Oct. 15, 2004 - Jan. 31, 2005	Oct. 1, 2005 - Mar. 1, 2006	Aug. 1, 2005 - Jan. 31, 2006	Aug. 1, 2006 - Nov. 1, 2006
Tax Years Covered	Before Dec. 31, 2003	Before Jan. 1, 2003		Before Jan. 1, 2004	Before Jan. 1, 2005	Before Jan. 1, 2005	Before Jan. 1, 2006
Applicable Law Limited to IRC 6011	Administrative Yes	Legislated No	Legislated Yes	Legislated No	Legislated No	Legislated No	Legislated Yes
Applicable to Promoters	No	No	Yes	No	No	No	No
Not Applicable to:	Individuals and businesses who have not filed an Arizona tax return.	Taxpayers participating in the IRS offshore VCI.		If late in paying back taxes or have not filed a tax return for other reasons.	Taxpayers (a) participating in the New York offshore VCI; (b) party to any federal or state criminal investigation for underreporting or underpayment of tax; (c) party to any pending admin. proceeding or civil or criminal litigation; (d) have been convicted of a crime.	Taxpayers (a) eligible to participate in the IRS offshore VCI or the son-of-Boss settlement initiative; (b) party to any criminal investigation; (c) have been convicted of a crime.	Taxpayers (a) are party to any federal or state criminal tax investigation; (b) are party to any pending admin. proceeding or civil or criminal litigation regarding the tax liability; (c) have a criminal conviction for the tax liability; or (d) eligible to participate in an amnesty program but did not do so and participated in the VCI of another state.

Table 3.
Tax Shelter Amnesties: Avoided Penalties, Amount Due, and Appeal Process

	Arizona	California	Connecticut	Illinois	New York	Minnesota	West Virginia
Avoided Penalties	75% of abusive tax shelter penalty	75% fraud penalty; 20% / 40% non-economic substance penalty; 20% / 40% accuracy-related penalty; 100% interest-based penalty	75% of abusive tax shelter penalty	Negligence penalty; fraud penalty; underreporting penalty; underpayment of tax; 100% interest penalty	Negligence penalty; fraud penalty; substantial understatement of liability penalty; reportable transaction understatement penalty; 100% interest penalty	Substantial understatement of liability penalty; reportable transaction understatement penalty	Understatement of underreporting of tax; failure to register shelter; promotion of tax shelters; 100% interest penalty.
Amount Due	Tax and interest	Tax and interest	Tax; interest (1% per month); 10% negligence penalty	Tax; interest (200% of regular rate)	Tax and interest	Tax and interest	Tax and interest
Extended Statute of Limitations		Yes - 8 years	Yes - 6 years	Yes - 6 years	Yes - 6 years		Yes - 6 years
Option With Appeal:	No	Yes	No	Yes	Yes	Yes	Yes
Avoided Penalties	N/A		N/A	20% reportable transportation penalty; 100% interest	5% negligence; 10% underpayment		Failure to report listed transactions
Option Without Appeal		Yes	No	Yes	Yes	Yes	Yes
Avoided Penalties	N/A		N/A	Negligence; fraud; underpayment of tax; reportable transaction; 100% interest	Underreporting; underpayment for liability;		Underreporting or underpayment for liability;

IV. Assessment of Amnesties

While amnesty programs have been widely used by the states, their use poses many questions. Do the programs actually increase government receipts over the long term? Are law-abiding taxpayers treated fairly? What are the long-term consequences of granting relief to tax evaders? Amnesty programs might best function as a valuable “carrot and stick” tool during the transition from one tax system to another or preceding major changes in administrative rules. The implementation of VCI programs or the SSUTA are good examples of major changes in tax administration or changes in information. The VCI programs announced major crackdowns on aggressive transactions that taxpayers likely considered legal when they entered into the transaction. Similarly, the sales tax enforcement environment has changed over time and states are more aggressive

in asserting nexus as remote sales continue to grow. The VCI and SSUTA amnesties provide taxpayers and the states with the opportunity for a clean slate. During the transition period, both can resolve difficult tax issues on a favorable basis along with reduced compliance and administration costs.

States may view amnesties as an inexpensive and politically popular way to raise short-term revenues. The state budget crises following the stock market crash of 2000 and the subsequent recession apparently motivated many states to offer amnesty programs this decade. Amnesty efforts clearly can restore short-term fiscal stability of state governments and are politically easier than tax rate increases or increased enforcement efforts. However, the limited empirical research on the subject indicates amnesties will have an ambiguous effect on long-term revenues.

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- Web site of the Streamlined Sales Tax Project, <http://www.streamlinedsalestax.org/>. ☆