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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

THE DIRECT MARKETING ASSOCIATION,

Plaintiff,

v.

CIVIL ACTION NO.

10-cv-01546-REB-CBS

ROXY HUBER, in her capacity
as Executive Director, Colorado
Department of Revenue,

Defendant.

* * * * *

DEPOSITION OF WILLIAM F. FOX

November 16th, 2010

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1 It is to my understanding a copy of
2 your report with your attached Vita. Have you had
3 an opportunity to look at that?

4 A I did, and I agree it does appear
5 to be my report and my attached Vita.

6 Q And on Page 5 of that document, is
7 that not your original, but is that your signature
8 there in this photocopy?

9 A It is.

10 Q And the date of the report is
11 November 5, 2010?

12 A That's correct.

13 Q Can you tell me in what areas you
14 are an expert?

15 A Well, generally, in economics and
16 also in taxation and with much of that focused on
17 state and local taxation.

18 Q Now, am I correct that the report
19 that you prepared in connection with this case
20 marked as Exhibit 95 was derived from another report
21 that you did outside of this litigation in 2009?

22 A That's correct.

23 Q And, in fact, on Page 1, you
24 indicate: "The estimates and methodology discussed
25 below are drawn specifically from the 2009 report

1 written by several colleagues and myself that is
2 referenced immediately above it."

3 Do you see that just below the
4 list?

5 A Just below the list. I think it's
6 true, I just don't see it on the page, but it is
7 true, nonetheless.

8 Q Just for purposes of the -- right
9 below the five bullets you'll see a sentence that
10 begins "the estimates and methodology."

11 A Yes.

12 Q And that's correct --

13 A That is correct.

14 Q -- that it's drawn from the 2009
15 report.

16 A Yes.

17 Q When was that 2009 report
18 published?

19 A Well, we prepared it in the late
20 winter and mostly in -- sorry, in the early and late
21 winter of 2009. It was published then in May of
22 2009.

23 Q Okay. As indicated, it was
24 published in State Tax Notes?

25 A That's correct.

1 Q We'll mark as the next exhibit this
2 document.

3 (Exhibit No. 96 marked)

4 Q So I'm showing you what we marked
5 as Exhibit 96, which is a document entitled State
6 and Local Government Sales Tax Revenue Losses from
7 Electronic Commerce dated April 13th, 2009. This
8 one is Bates stamped WF000033 through WF000068.

9 Is that there the report that you
10 just described that was published in the State Tax
11 Notes in May 2009?

12 A It certainly looks to be, yes.

13 Q And is that the report that has
14 formed the basis of your report in this case,
15 Exhibit 95?

16 A Yes.

17 Q In preparing Exhibit 95, did you,
18 in essence, extract data specific to Colorado from
19 your 2009 report?

20 A Yes, plus describe a general
21 methodology.

22 Q In preparing Exhibit 95, did you do
23 anything to update your work from 2009?

24 A No. Well, let me -- let me make an
25 exception to that. I did, however, go back and

1 compare estimates that were included in the 2009
2 report with data that are currently available from
3 the U.S. Department of Census. I do remember adding
4 that.

5 Q Okay. Other than that update with
6 regard to a comparison to census data or data
7 available from the U.S. Census Bureau, anything else
8 to update it?

9 A I don't think. And then the data
10 for Colorado that are used in my current report did
11 come, for Colorado, did come from this 2009 report.

12 Q How many hours did you spend
13 preparing Exhibit 95?

14 A Well --

15 Q The report in this case.

16 A Yeah. What I have spent is 15
17 hours on the case in total. That includes preparing
18 the report, gathering documents for you and for the
19 Attorney General's Office, you know, getting my
20 resume prepared and so forth.

21 Q Okay. Are you able to isolate from
22 the 15 hours how much time was spent preparing the
23 actual report?

24 A I didn't keep my time in that
25 fashion.

1 A No.

2 Q Can you tell me what you discussed?

3 A I would describe it as general
4 advice for me in terms of the deposition, things
5 like make sure to answer the questions that you ask,
6 that sort of general advice. I don't remember
7 any -- any noticeable conversation about the
8 substance of the report itself.

9 Q Okay. Did you talk about any other
10 issues not contained in your report that -- related
11 to sales and use tax?

12 A You know, let me admit that I'm a
13 person who doesn't remember telephone conversations
14 all that well, and we did have conversations, I'm
15 not sure I'll be able to give you any specifics, it
16 wasn't that long of an overall telephone call, but
17 about some other kinds of questions that might be
18 posed.

19 But, you know, just that, just a
20 couple of examples of the kinds of questions that
21 might be posed.

22 Q What other kinds of questions did
23 you talk about?

24 A That's what I'm trying to remember
25 and -- you know, one issue I remember us talking

1 about was, you know, the best approach to dealing
2 with states' difficulties in collecting sales and
3 use taxes on remote commerce. That's actually
4 literally the only example that occurs to me.

5 Q What do you mean by dealing with
6 states difficulties in collecting remote -- taxes on
7 remote sales?

8 A My view is that states and local
9 governments need to be able to effectively
10 administer the sales and use tax on all sales to
11 their residents and businesses, and the Colorado
12 statute is one approach to -- to dealing with that
13 issue.

14 Q Come back to that in a moment.
15 Did you communicate about any other
16 subjects that you can remember?

17 A Nothing else that I remember.

18 Q Did you communicate by e-mail in
19 preparation for this deposition?

20 A No.

21 Q How much time did you spend
22 preparing in total?

23 A For the deposition itself?

24 Q Yes, for the deposition.

25 A About two hours including reading

1 business that did not market to Colorado, for
2 example, or a particular state; in other words,
3 there's no reason not to market to a state, per se?

4 A It just would depend --

5 MS. SNYDER: Objection to the form.

6 Q You can go ahead.

7 A It would depend on what they're
8 selling, I think, as to whether or not Colorado
9 would be a target for a particular thing or not.

10 Q But an internet seller, and you've
11 analyzed e-commerce, correct?

12 A Yes.

13 Q So you're actually talking about
14 internet sellers. Internet sellers, their websites
15 are available essentially indiscriminately over the
16 United States to those who have access to the
17 internet?

18 A Yes.

19 Q For purposes of allocating income
20 or allocating sales, rather, for your report, you
21 have allocated the e-commerce sales based, as I
22 understand it, on -- well, tell me and I'll see if I
23 can find it in the report. Based on their share of
24 total state and local tax revenues?

25 A That's correct.

1 Q And this allocated about
2 1.7 percent of the national e-commerce sales in each
3 category to Colorado, is that correct?

4 A Yes, that is correct.

5 Q So if we were using that measure,
6 1.7 percent, we could take a firm's national sales
7 and we could apply 1.7 percent to get an estimate of
8 its Colorado sales?

9 A Well, let me re-emphasize, that
10 we're in no way trying to apply this to individual
11 firms --

12 Q Correct.

13 A -- so what one can do in an
14 aggregate sense and is meaningful is very different
15 from what makes sense to apply to a particular
16 business. That's the part that I am being hesitant
17 about here.

18 Q Okay. But over the run of
19 businesses in the United States, you've done this to
20 apply it to sales of e-commerce nationally --

21 A Yes.

22 Q -- and you've used that percentage
23 to -- that 1.7 percent against national e-commerce
24 sales?

25 A That's correct.

1 Q So over the run of businesses
2 dealing in e-commerce, you've viewed it as being a
3 reasonable measure to apply about 1.7 percent of
4 those sales to Colorado?

5 A We do.

6 Q Page 2 of your report, Exhibit 95,
7 under the heading Estimated Sales and Use Tax Losses
8 for Colorado, you provide certain estimates, is that
9 correct?

10 A Yes.

11 Q And to be more specific, why don't
12 you tell me what those estimates are listed there in
13 the first line of that section?

14 A The estimates are the dollar amount
15 that we believe will go uncollected in Colorado in
16 2010, 2011, and 2012 because of the state's
17 inability to fully collect the sales and use taxes
18 due on e-commerce sales.

19 Q Okay. And what you're measuring
20 there is the loss on all e-commerce sales delivered
21 into Colorado?

22 A That's correct.

23 Q And I think as you note on the same
24 page in the prior paragraph, these are almost
25 exclusively use taxes, not sales taxes?

1 A Yes.

2 Q When you say almost exclusively,
3 what percentage are we talking about?

4 A Yeah, I mean it's very high. It's
5 hard for me to come up with examples when it would
6 not have been a use tax situation that's involved,
7 but I'm not saying it's impossible, it's just -- all
8 the examples that I think of would be use tax.

9 Q Now, if you look at your April 2009
10 report, Exhibit 96, Page 4 of that report --

11 A Okay.

12 Q -- talking about national findings,
13 you indicate there at the top of Page 4, and tell me
14 if I read these right:

15 "These losses are equal to what
16 states would collect if they could achieve
17 100 percent compliance on the sales and use
18 taxes due on e-commerce sales, and arise
19 because states are unable to enforce
20 collection, particularly because of
21 limitations such as those imposed by Quill
22 v. North Dakota."

23 Did I read that right?

24 A You did.

25 Q And is that same statement

1 applicable to the estimates you have here in Exhibit
2 95 with regard to Colorado?

3 A Yes.

4 Q So these are amounts that could be
5 collected if Quill v. North Dakota were overturned
6 by the Supreme Court or by federal legislation
7 enacted by Congress, is that correct?

8 A And if there was 100 percent
9 compliance.

10 Q So Quill would need to be
11 overturned by the legislation or by the Supreme
12 Court, 100 percent compliance. Is it also true
13 that, I think you note in your 2009 report that it
14 presumes there's no small seller exception?

15 A That is true.

16 Q Okay.

17 A If it were federal legislation, it
18 would depend on the characteristics of that
19 particular federal legislation.

20 Q And, in fact, isn't it true that
21 your longer report from 2009 has been cited by
22 advocates of federal legislation seeking to overturn
23 Quill as a -- in support of their efforts to
24 convince Congress to enact such legislation?

25 A At least they've used the numbers

1 Q So you have year by year and then
2 the far right column is an average of those years.

3 Do you see that with regard to
4 both, assuming a small business exception and then
5 assuming there is no small business exception, that
6 Eisenach and Litan conclude that the average
7 uncollected use tax on e-commerce is something less
8 than half of your estimate?

9 A I do see that.

10 Q Now, are you aware that there are
11 others besides Eisenach and Litan, who have also
12 opined that your estimates might be too high?

13 A I am.

14 Q We'll mark as the next document
15 this Exhibit 98, which I have handed you and,
16 Melanie, I'll read it carefully for you, it's a
17 document entitled "Setting The Record Straight: The
18 Modest Effect of E-commerce on State and Local Sales
19 Tax Collections," prepared by Peter A. Johnson,
20 Ph.D., and this dated July 31, 2008.

21 (Exhibit No. 98 marked)

22 Q Now, among the folks who have
23 offered counter-estimates is, in fact, the Direct
24 Marketing Association, is that correct?

25 A That was my understanding, right.

1 But I was not familiar with this report.

2 Q Okay. Professor Johnson is, as
3 identified here, is a senior economist with the
4 Direct Marketing Association.

5 A Okay.

6 Q Were you aware that Professor
7 Johnson had prepared a report?

8 A I was not. I was aware that Direct
9 Marketing Association, in my memory, had done one
10 some years before, I was not aware of this study.

11 Q Okay. Several years before in
12 connection with federal legislation that had been
13 pending before Congress at the time?

14 A Well, back in the early 2000's when
15 our first report was put out, my remembrance is that
16 the Direct Marketing Association had a response at
17 that time.

18 Q Okay. And if you look at this
19 document, Exhibit 98, turn to Page 8, if you would,
20 and you'll see that on Page 8 there is a Table 5
21 that is entitled "Total Unremitted Tax on E-commerce
22 Sales in Billions," and it gives a listing by year
23 for 2005 through 2008. Do you see that?

24 A I do.

25 Q And the total uncollected tax

1 identified in Professor Johnson's report for 2008 is
2 estimated to be 5.4 billion?

3 A Yes.

4 Q And in your report, Exhibit 96, at
5 Page 7, so your 2009 report, which is Exhibit 96, if
6 you turn to Page 7?

7 A Yeah.

8 Q Your estimate for 2008 with
9 baseline as opposed to optimistic was 7,726,000,000?

10 A That's correct.

11 Q So --

12 A I'm sorry, seven billion, seven
13 hundred --

14 Q Twenty-six?

15 A Sorry, sorry, you're right, you're
16 right.

17 Q So Johnson's estimate is about
18 30 percent less than your estimate for 2008?

19 A That sounds about right, yes.

20 Q With regard to your report, Exhibit
21 95, you've relied on various sources of information
22 cited in your report to support your conclusions
23 regarding the level of uncollected sales and use tax
24 in Colorado as set forth in the report?

25 A That's correct.

1 Q And those sources, many of them are
2 cited also in the 2009 report regarding the
3 nationwide picture?

4 A Yes.

5 Q Among those is a compliance stated
6 by the Washington Department of Revenue?

7 A That's correct.

8 Q Do you recall that?

9 A Yes.

10 Q And so, for example, I think it's
11 cited in two places, at least it's identified in
12 Footnote 3, I believe, first, on Page 3, and then
13 again in Footnote 12 on Page 5.

14 A Yes.

15 Q And for what principle or point did
16 you rely upon the Washington Department of Revenue
17 study?

18 A One aspect of the study is -- of
19 our study, is to be able to anticipate what level of
20 compliance is anticipated both with use tax by
21 vendors when they comply and by use tax when
22 individuals or businesses comply. The Washington
23 study provides estimates of that.

24 Q The Washington study is a business
25 compliance, yes?

1 A Yes.

2 Q So it's a B to B sales -- and it's
3 use tax compliance as well as sales tax compliance?

4 A In fact, all taxes.

5 Q Okay, by Washington businesses.

6 So -- and the report that you
7 relied upon indicates it was from 2008?

8 A That's correct.

9 Q Okay. So looking at your report at
10 Page 3, I believe you indicate that there is
11 approximately 25 percent noncompliance with
12 e-commerce sales for use tax, is that -- do I have
13 that right?

14 What is the level of, based on the
15 Washington report, the level of noncompliance with
16 use tax for businesses?

17 A Right. I want to be clear, the
18 numbers in this paragraph that you're referring to
19 on Page 3 did not derive directly and solely from
20 the Washington study. We do use the 75 percent
21 compliance rate, I'm being approximate now, from the
22 Washington study in our calculations.

23 It just so happens that it's also
24 true that when you work through all of our
25 calculations, you end out with about 75 percent

1 compliance overall with e-commerce and that's what's
2 being reported in the paragraph that you're
3 referring to.

4 Q So when you say overall compliance,
5 it's by businesses with regard to reporting use tax
6 on e-commerce?

7 A And by individuals. And so what we
8 have is both. What's going on in our calculations
9 here is, first of all, allowing for the possibility
10 that there is sales tax compliance by firms that
11 either have nexus or agree to voluntarily comply
12 with the tax. And then -- and then a second level
13 is for those transactions where vendor compliance
14 did not take place, we then allow for use tax
15 compliance. And so we're doing that at both levels
16 for both B to B and B to C transactions.

17 Q Okay. And that's what you're
18 saying is in the paragraph on Page 3 that we're
19 looking at?

20 A That's right, is an aggregate of
21 all of our analysis that's in that paragraph.

22 Q But if I want to focus for a moment
23 on the use tax compliance by businesses --

24 A Yes.

25 Q -- is that a -- is that number

1 derived from the Washington study?

2 A Yes, it's taken from the Washington
3 study.

4 Q Okay. And there's -- with regard
5 to business compliance with regard to sales tax, it
6 appears that you indicate that it's about a
7 1.7 percent noncompliance rate by businesses in the
8 Washington study with regard to sales tax?

9 A That's correct.

10 Q And just to be clear, those are
11 businesses registered in the state of Washington?

12 A That's correct. The Washington
13 study, in fact, underestimates noncompliance because
14 it only includes registered vendors.

15 Q Obviously, the problem that you
16 have attempted to describe in your report, if the
17 1.7 percent were the national compliance rate on
18 sales taxes, it wouldn't be nearly the same issue.

19 I mean, in other words, the
20 1.7 percent, that would indicate 98.3 percent by all
21 firms nationwide and that's not what we're talking
22 about here, this is Washington registered
23 businesses?

24 A Right.

25 MS. SNYDER: Objection to the form.

1 MR. SCHAEFER: Fair enough.

2 Q Go ahead if you understood it.

3 A I mean, this does refer
4 specifically -- the 1.7 percent refers specifically
5 to compliance in the state of Washington by
6 registered vendors. It does not include
7 nonregistered vendors that might, in fact, have
8 nexus under current constitutional rulings in the
9 state, but aren't choosing to comply with the law.

10 Q Right.

11 A And I can give you a variety of
12 examples of why that and how that might be
13 happening. And so we view both the sales and use
14 tax estimates as lower bounds of what the reality is
15 in the state of Washington.

16 Q At the risk of getting way too
17 sales and use tax wonky, the -- in fact, the firm
18 that may have nexus, but isn't registered, their
19 liability may actually be for use tax and, in fact,
20 it may be a use tax they should be collecting
21 because they may not be --

22 A It could be, but it doesn't need to
23 be. You could envision a situation along the
24 Washington border where you have Oregon with no
25 sales tax and Washington with a sales tax, and you

1 could envision a situation, in fact, accountants
2 tell me this absolutely happens with great degree of
3 regularity where firms driving from Oregon into
4 Washington, thereby almost surely establishing
5 nexus, engaging in selling their product, driving
6 back to Oregon and delivering it by common carrier
7 from Washington -- from Oregon and saying we have no
8 sales tax liability and not registering, that's a
9 use tax problems. Sorry, sorry, that's a sales tax
10 problem.

11 They're in Washington, they have
12 physical presence in Washington, it's a transaction
13 in Washington, might even be drop-shipped into
14 Washington, and so you know it could be either one,
15 just depends on the specifics of the situation.

16 Q That did get too sales and use tax
17 wonky.

18 You applied the rates, though, the
19 Washington rates with regard to -- of compliance
20 rates from the Washington DOR study with regard to
21 the estimates for Colorado?

22 A That's correct.

23 Q Now, it's true, is it not, that use
24 tax compliance rates, in fact, vary state to state?

25 A They will.

1 Q Is there a reason that you've used
2 the Washington study?

3 A Yes, because Washington -- and let
4 me note here, there have been a series of these
5 Washington studies. We relied on the most recent
6 one for this particular analysis, but we have relied
7 on earlier ones for other estimates that we did.

8 And the results in them are very
9 consistent, very, very little deviation in terms of
10 their compliance rates. And so it's a consistent
11 set of studies from the state of Washington.

12 Q Okay.

13 A And to our knowledge, they are the
14 best estimates of sales and use tax compliance that
15 are available for U.S. states.

16 Q Okay. When you said they are
17 consistent, you meant within Washington study to
18 Washington study, they are consistent?

19 A I did mean that, yes.

20 Q If the Colorado experience differ
21 in some respects in terms of compliance, that would
22 change your estimates. If you had correct
23 information for Colorado, if it were available, as
24 you say, it would change the estimates with regard
25 to Colorado?

1 A It could either decrease or
2 increase the revenue implications for Colorado.

3 Q But you think the Washington study
4 is a reliable one and a good basis for estimating
5 compliance in other states, including Colorado?

6 A Yes.

7 Q Now, you mentioned they have data,
8 are you aware that the Washington DOR, in fact,
9 updated its study in August of 2010?

10 A I have not gone out and looked at
11 it.

12 Q Okay.

13 A Thank you for letting me know.

14 Q Your report, of course, continues
15 to rely on the 2008 study?

16 A Well, because we didn't redo the
17 report, yes.

18 Q I'm going to mark a copy of that
19 2010 Washington DOR compliance study as the next
20 exhibit, I think as Exhibit 99.

21 (Exhibit No. 99 marked)

22 Q So handing you a copy of Exhibit
23 99, which is a document entitled Department of
24 Revenue Compliance Study, it's on State of
25 Washington Department of Revenue letterhead,

1 indicates that it was prepared -- dated August 20th
2 of 2010.

3 Does this look similar in format to
4 the other studies from Washington that you recall?

5 A It does.

6 Q And if you look at Page 2, there's
7 a chart on Page 2, which in fact compares the 2008
8 compliance study that you've relied upon to the 2010
9 compliance study. Do you see that?

10 A I do.

11 Q So looking at first a use tax, it
12 indicates that the rate of noncompliance for 2010 is
13 estimated to be 23 percent as opposed to the
14 25.5 percent from 2008?

15 A Yes, that's correct.

16 Q Okay. Now, if you use this new
17 rate, this new 23 percent rate instead of 25.5, that
18 would reduce somewhat your estimates of uncollected
19 tax, would it not?

20 A If I were going to redo the study,
21 I would of course redo all of the numbers, I
22 wouldn't just pick one number and make a change. I
23 would use -- if I were to redo my 2009 study, I
24 would use this 23 percent use tax compliance, but I
25 also would make a lot of other changes, including

1 the fact that our estimates of e-commerce are much
2 lower than the reality that we've seen in the
3 meantime.

4 Q I'm trying to isolate the effect of
5 this change, that this particular updated report
6 would indicate that there is a lower level of
7 noncompliance, at least according to the Washington
8 Department of Revenue, than you had estimated for
9 your 2009 report?

10 A Than what we used in the earlier
11 report, that's correct.

12 Q And than used in your Exhibit 95,
13 your report in this case?

14 A That's correct.

15 Q And in looking at the sales tax
16 line immediately above it, that indicates that
17 noncompliance with the sales tax, again by
18 Washington registered businesses, is now one percent
19 estimated for 2010 as compared to the 1.7 percent
20 estimated for 2008?

21 A That's correct.

22 Q And so similarly, just isolating
23 that effect, that would have the effect of reducing
24 estimated levels of uncollected or unreported tax
25 all other things being equal?

1 A All other things being equal, but
2 they are not equal, I have to re-emphasize.

3 Q So in terms of just that effect,
4 the effect of that change, of that indication that
5 there is a somewhat higher compliance rate, lower
6 noncompliance rate for the sales tax with regard to
7 registered businesses, that would tend to reduce the
8 estimates of uncollected tax.

9 A Holding everything else equal,
10 that's not equal, that's correct.

11 Q In your report, Exhibit 95, you
12 also relied upon a University of Maryland study,
13 which I believe is cited in Footnote 11 --

14 A Yes.

15 Q -- Page 5.

16 A Yes.

17 Q And this is a study from a group of
18 academics at the University of Maryland, is that
19 correct?

20 A Yes.

21 Q So I'm going to mark a copy of
22 that, which is among the documents that you produced
23 or that the Attorney General's Office produced in
24 connection with your report, and mark that as
25 Exhibit 100.

1 (Exhibit No. 100 marked)

2 Q So I'm handing you Exhibit 100,
3 which is a document Bates stamped -- and when I say
4 Bates stamped, Professor Fox, maybe you're familiar
5 with it from other cases, maybe you're not, the
6 Bates numbers is the lower right-hand number that
7 attorneys in litigation assign so that they can keep
8 track of documents by a more simplified numbering
9 system rather than having to do something else, so
10 we know what we're looking at. This one's Bates
11 stamped WF000177 through WF000184. And the document
12 is entitled "The Tail is Longer Than You Think: The
13 Surprisingly Large Extent of Online Sales by Small
14 Volume Sellers."

15 The authors are Joe Bailey,
16 B-A-I-L-E-Y, and a series of other individuals
17 identified as being associated with the Robert H.
18 Smith School of Business at the University of
19 Maryland, and the report is dated May 12, 2008,
20 marked draft.

21 Is this the document that you cite
22 in your report, Exhibit 95?

23 A It is.

24 Q Now, you state on Page 5 of your
25 report, Exhibit 95, our survey -- excuse me, strike

1 that.

2 Looking at the sentence to which
3 the Footnote 11 is attached: "Vendor compliance
4 relies on a survey of large internet vendors and the
5 Maryland Long Tail Study."

6 A Yes.

7 Q This document, Exhibit 100, is the
8 Maryland Long Tail Study?

9 A That's correct.

10 Q To make sure that I'm not missing
11 something, can you show me where in Exhibit 100, the
12 Maryland Long Tail Study, the authors of that study
13 analyze vendor compliance with sales and use tax?

14 A Well, they don't.

15 Q Oh, okay.

16 A I think that wasn't exactly what it
17 said. It said that our vendor compliance relies
18 upon that study, but we don't use compliance numbers
19 from that study.

20 Q Okay, so you're not relying on the
21 study for rates of compliance?

22 A That's right.

23 Q What are you relying upon the
24 Maryland Long Tail Study for?

25 A For a distribution of the size of

1 e-commerce vendors.

2 Q So, help me out with what you mean
3 by the distribution of the size of e-commerce
4 vendors?

5 A There are a relatively small number
6 of large, as measured by volume, e-commerce vendors.

7 Q Volume of sales?

8 A Volume of sales. There are a huge
9 number of small vendors as measured by volume of
10 sales, and that is -- that information is drawn from
11 this report.

12 Q Okay. I believe that you also cite
13 the Long Tail Study in your 2009 report, Exhibit 96.

14 A I'm sure we do.

15 Q And if you'll get that document,
16 I'll find the reference I'm looking for. Marked as
17 an exhibit, the one that has some highlighting in
18 it, which is fine with me.

19 A Page 5, is that what you're looking
20 for?

21 Q It could be.

22 A Second paragraph.

23 Q Thank you.

24 So in the second paragraph on Page
25 20 of Exhibit 96, there is a similar statement you

1 make: "The vendor tax compliance was informed using
2 the results from the Maryland Long Tail Study."

3 And then it goes on to say:

4 "The study evidences that
5 37 percent of e-commerce is conducted by
6 large vendors, 20 percent by medium size
7 vendors that generally maintain their own
8 website and have annual gross receipts
9 between \$1 million and \$10 million, and
10 43 percent by vendors that operate on a
11 platform other than their own and have sales
12 under \$1 million."

13 Did I read that right?

14 A Yes.

15 Q And is that the principle on which
16 you -- for which you rely on the Maryland Long Tail
17 Study?

18 A Yes.

19 Q So, in other words, you're using it
20 to determine relative amounts of electronic commerce
21 conducted within those three segments of businesses?

22 A Yes. I mean, that is -- we do use
23 the information the way you just described it, yes.

24 Q So the three groups are over ten
25 million in annual sales, gross receipts or sales

1 between one and ten million, and gross receipts
2 under one million?

3 A Yes.

4 Q Okay. Now, the study is marked
5 draft, but do you consider the study, the Maryland
6 Long Tail Study, to be a reliable -- to be reliable
7 in its estimate of the amount of e-commerce sales in
8 each of those groups that I just listed?

9 A Well, you know, at the time I read
10 it, the methodology seemed reasonable and was done
11 by people, who had, you know, worked a lot on
12 internet-based issues and so we did accept that as a
13 reasonable estimate, yes.

14 Q Okay. And you relied on it in your
15 report that's marked as Exhibit 95 in this case?

16 A Yes.

17 Q So you continue to think it's
18 reasonable, at least as of preparing that report?

19 A Yes.

20 Q And I assume as you're sitting here
21 now?

22 A Yes.

23 Q And what the Maryland Long Tail
24 Study shows is there is a significant amount of
25 electronic commerce that is conducted by firms with

1 sales under \$1,000,000?

2 A Yes.

3 Q By your calculation from the study,
4 43 percent, in fact, of e-commerce is conducted by
5 firms with sales under one million?

6 A From their calculations, yes.

7 Q From the Maryland Long Tail Study.

8 A Yes.

9 Q Now -- and you've used that number
10 yourself, that estimate of 43 percent of below one
11 million in preparing your 2009 report and in
12 connection with your report in this case?

13 A That's correct.

14 Q Now, on Page 20 of your report from
15 2009, you also indicate at the end of that same
16 paragraph that you assume that small vendors only
17 comply part of the time, even within their home
18 states, you assume a one percent compliance?

19 A Yes.

20 Q So in addition to there being a
21 fairly high volume of sales among that segment under
22 one million, total e-commerce sales being something
23 like 43 percent of all e-commerce sales made by
24 firms under a million, those same firms also exhibit
25 low compliance?

1 A That's correct.

2 Q Now, so am I correct then, given
3 the high volume of sales among sellers under a
4 million in the aggregate, and their low levels of
5 compliance, that exempting small sellers from the
6 obligation to report sales and use tax will
7 significantly reduce the estimates of uncollected
8 tax that can be obtained?

9 A Well, it doesn't reduce the
10 estimates. It does, however, if you had a small
11 seller's exception, which said they don't have to
12 comply and they don't have to pay tax, then you'll
13 reduce what you get from a more -- a broader
14 requirement to collect the tax.

15 Q Okay, that's better stated.

16 So, were you to institute, either
17 an overturning of Quill or some other program that
18 would require the collection of sales and use tax on
19 e-commerce sales by businesses regardless of their
20 nexus, but except from that, those small sellers, it
21 would reduce --

22 MS. SNYDER: Object to the form.

23 And, Matt, you're starting to cut out toward
24 the end.

25 MR. SCHAEFER: Okay, I think the

1 reason it sounds like I cut out is because
2 I'm trying to form the question. So -- in
3 fact, I hadn't finished my question.

4 MS. SNYDER: Okay, I apologize. It
5 just got very quiet and I could hear a
6 little bit of noise, I couldn't tell if you
7 were still talking or not.

8 MR. SCHAEFER: Yeah. I think what
9 you are probably hearing is the typing or
10 fan noise or something, but let me try
11 again.

12 BY MR. SCHAEFER:

13 Q Dr. Fox, I think you clarified to
14 say essentially that you will -- were you to
15 institute a program requiring the collection of
16 sales and use tax on e-commerce sales, however that
17 might occur, through an overturning of Quill or
18 otherwise, but except from that requirement, small
19 sellers, under a million dollars, it would reduce
20 significantly the amount of additional tax you could
21 collect?

22 A Based on the numbers I've seen,
23 yes, it would.

24 Q And I think you indicate that
25 elsewhere in your 2009 study, perhaps in a slightly

1 different context, but if you look at Pages 13 and
2 14, you have a section in your 2009 study about
3 small seller exceptions or de minimis exceptions.

4 At the bottom of Page 13 you say,
5 for example, the last paragraph in the middle of
6 Page 13:

7 "This means, for example, that the
8 price tag for a \$1 million small vendor
9 exception is 30 percent as large as our
10 estimate of losses in 2012."

11 Did I read that correctly?

12 A You did.

13 Q Okay. Now, why, if sellers under a
14 million dollars account for 43 percent of all
15 e-commerce sales and have a very low compliance
16 rate, do you estimate a small seller exception set
17 at a million dollars will result in only a
18 30 percent reduction in uncollected tax?

19 A Well, remember in every case here,
20 we have two levels of compliance that are going on.
21 The first level is compliance by the vendor, and the
22 discussion that we've been having about these small
23 firms refers only to small vendor compliance.

24 Then there's this second level of
25 compliance, which is compliance by the buyer. And

1 in the case of businesses, we're using about
2 75 percent compliance. So our calculations are a
3 complicated function of what happens at that first
4 stage, does the vendor collect it, and then for
5 those sales which the vendor doesn't collect, what
6 kind of compliance do we get by the buyer. Both
7 steps are going into the calculation and that's why
8 it's not this simple arithmetic that you're looking
9 for here.

10 Plus, we actually assume a higher
11 share of vendor compliance for B to B sales than we
12 do for B to C sales. In the part that you're
13 referring to from later in my text there on, like
14 around Page 20, is mostly referring to B to C sales.

15 Q So the 43 percent estimate is all
16 sales -- 43 percent of all e-commerce at that level
17 of under a million dollars for the amount of
18 sales -- strike that.

19 The 43 percent of e-commerce, total
20 e-commerce sales represented by sales of firms
21 having sales less than a million is both B to B and
22 B to C?

23 A Yeah, that's my understanding from
24 their study.

25 Q Now, on the top of Page 14, you

1 provide a table showing the small vendor exception
2 at different levels of sales for the small vendor?

3 A That's correct.

4 Q And your levels of sales are below
5 500,000, below 1,000,000 and below 5,000,000?

6 A That's correct.

7 Q And you have calculated the impact
8 on taxes that are available to be collected based on
9 each of those thresholds of small seller exception?

10 A That's right.

11 Q And at a \$5 million small vendor
12 exception causes, not surprisingly, an even larger
13 reduction in your estimate of uncollected tax,
14 correct?

15 A That's correct.

16 Q And the percentage, instead of the
17 30 percent you mentioned on the prior page, is
18 something more like 36.85 percent?

19 A It looks like you've calculated
20 that on the copy I'm looking at, so I'll accept that
21 as correct.

22 Q And just so you'll know, what I've
23 done for 2010 was to take your number from your
24 chart, the Table 8 on Page 14, of 3,177,000,000 and
25 divide it by your estimate from Page 7, baseline

1 estimate from Page 7 of total estimated state and
2 local revenue loss.

3 A Yes.

4 Q And so I did the math correctly
5 there?

6 A It looks like you did.

7 Q I picked the right numbers?

8 A Yes, I think so.

9 Q The correct numbers for 2010.
10 So the impact of that \$5 million
11 small vendor exception would be about a
12 36.85 percent reduction in available uncollected
13 tax?

14 A It would be large.

15 Q You don't have an issue with my
16 math.

17 A It looks correct. I didn't check
18 it, but it looked like you got the right numbers.

19 Q Now, would a small seller exception
20 that was set even higher than five million, say at
21 six million, reduce your estimates of uncollected
22 tax available to the states even more?

23 A Let me re-emphasize, it's not
24 changing our estimates of uncollected tax, it's
25 changing the estimate of what you might expect to

1 collect if you required remote vendors of a
2 particular size to collect at the vendor level.

3 Q Yes. But if we except those
4 sellers from the obligation to collect, in effect,
5 the tax -- well, fair enough. It would reduce
6 further, if we raised the small seller exception
7 above five million, it would reduce further the tax
8 available to be collected by the states?

9 A The tax that we would expect states
10 to actually be able to collect.

11 Q Okay.

12 A Not the amount that is owed.

13 Q No.

14 A That's unaffected by these kinds of
15 assumptions.

16 Q Right, and I used available and
17 I'll accept your word of able to be collected,
18 that's fine.

19 But you haven't estimated any
20 higher thresholds than five million for a small
21 seller exception?

22 A We have not.

23 Q Okay, you haven't estimated six
24 million?

25 A No.

1 Q Or 6.25 million?

2 A Nothing higher than five million.

3 To my remembrance at least, I don't remember us
4 doing anything. We reported only the numbers we
5 calculated as I remember.

6 Q There's certainly nothing reported
7 in Exhibit 96 above five million.

8 A And I did no work associated with
9 the small seller exception, per se, on the work for
10 Colorado.

11 Q Now, are you familiar from your
12 work generally in the field with efforts by states
13 to improve use tax reporting and compliance by
14 consumers and businesses?

15 A I think they're continuing
16 regularly to do that. I'm not a person, who works
17 on administrative issues, per se, but that's
18 certainly my sense, that states are trying to do
19 that.

20 Q Are you aware of those kinds of
21 efforts?

22 A Well, I mean the one that I'm
23 obviously aware of is the efforts by states to
24 include a line on their income tax return, which
25 about 20 states do, that give people an opportunity

1 to report. The numbers that I have seen over the
2 years suggest very little compliance with that.

3 I think states are continuing to
4 try to improve their auditing techniques, which are
5 applied essentially only to businesses, but the odds
6 again remain very infrequent and of modest success
7 as best I can see.

8 Q So you've identified inclusion of a
9 use tax line on the individual tax return and audit.
10 Are there any other efforts that you're aware of by
11 states to improve use tax compliance and reporting
12 by consumers?

13 A Those are the ones that occur to me
14 off the top of my head.

15 Q Have you worked with any states or
16 state departments of revenue in developing consumer
17 compliance initiatives for the use tax?

18 A No.

19 Q And are you aware of any other
20 initiatives with regard to business compliance with
21 the use tax that states or state departments of
22 revenue have undertaken?

23 A Nothing occurs to me.

24 Q And have you advised any states
25 with regard to such initiatives for business tax for

1 use tax compliance by businesses?

2 A No.

3 Q Now, you mentioned the use tax line
4 on the income tax return as one of those measures.
5 And you estimated about 20 states have such a line?

6 A There was a study at one point that
7 was available on the FTA website. My remembrance,
8 though this might be incorrect, is that it was
9 written by a person from the Minnesota Department of
10 Revenue research staff and it had a listing of such
11 states. And my remembrance at the time was that
12 there were over 20 on that list.

13 Q Do you know if Colorado is one of
14 those states?

15 A I think Colorado is not one of
16 those states.

17 Q Is not.

18 I'm going to mark as the next
19 exhibit, which is Exhibit 101, a document entitled
20 "Use Tax Collection on Income Tax Returns in Other
21 States" from the Research Department of the
22 Minnesota House of Representatives. This one is --
23 was updated June 2010.

24 Is this the Minnesota report you
25 just referred to?

1 (Exhibit No. 101 marked)

2 A Except I'm talking about an earlier
3 draft. This is one that I saw several years ago,
4 and so thank you for alerting me that this more
5 recent report is available now.

6 Q So, in fact, it was updated in
7 2010. Does it appear to be in the same sort of
8 format as you're aware of?

9 A I think so. Generally it looks
10 like what I have seen.

11 Q Earlier you mentioned that you
12 advised the legislature in Minnesota on sales and
13 use tax compliance efforts. Did you have any role
14 in the development of this report?

15 A Well, let me be a little more
16 precise about what I did. I testified on tax policy
17 issues in Minnesota, not tax administration issues,
18 which is generally what -- where my expertise lies.
19 And so I have not played any role whatsoever in this
20 report. I was just familiar with an earlier draft
21 of it.

22 Q Okay. And just to clarify the
23 number you mentioned earlier, you believed it to be
24 about 20 states, if you look at Page 2 of this
25 report, the third full paragraph indicates that "23

1 Minnesota's exclusion of clothing from the
2 sales tax base."

3 Q Do you see that, Dr. Fox?

4 A I do, yes.

5 Q Were you aware that Minnesota
6 exempted clothing from the sales tax?

7 A I was.

8 Q Do you know if Colorado exempts
9 clothing from the sale and use tax base?

10 A I don't think so, but I don't know
11 that.

12 Q If Colorado does not, would you
13 agree with me that it would potentially have
14 higher --

15 A Well --

16 Q -- revenues than Minnesota subject
17 to --

18 A I'm sure there are many, many other
19 differences in their tax bases and so I wouldn't
20 just apply a Minnesota result to another state
21 without looking at the characteristics of that
22 state's tax structure and the breadth of its tax
23 base.

24 Q But what the Minnesota House of
25 Representatives has done here is analyzed all the

1 MR. SCHAEFER: She can read it
2 back. He said it was an issue he hadn't
3 studied.

4 THE WITNESS: And I couldn't offer
5 an opinion.

6 MS. SNYDER: Okay.

7 BY MR. SCHAEFER:

8 Q We've been talking about use tax
9 compliance by individuals. With regard to use tax
10 compliance by businesses, I believe you indicated
11 that additional audit efforts was one area of
12 activity that states have engaged in to try and
13 increase use tax compliance by businesses, is that
14 right?

15 A That's correct.

16 Q Now, am I correct that the
17 overwhelming portion of e-commerce is business to
18 business sales?

19 A Yes.

20 Q About what percentage of e-commerce
21 is business to business sales?

22 A It's over 90. I think the most
23 recent number I had seen was 93 percent, recognizing
24 that we're approximate in the categorization here.

25 Q Okay. Now, am I also right that

1 businesses tend to -- transactions between
2 businesses tend to less often be subject to sales
3 and use tax?

4 A Yes.

5 Q And I think you've already
6 testified today that there tends to be a higher rate
7 of compliance for a use tax among businesses than
8 consumers?

9 A That's correct.

10 Q So those two factors, it seems to
11 me, but you correct me if I'm wrong, would tend to
12 reduce the relative share of unreported tax by
13 businesses below 93 percent?

14 A Yes, that's true.

15 Q Do you know about what portion of
16 unreported use tax is by businesses?

17 A We don't report that in this study.
18 I believe in one of our earlier studies we had it
19 about 50/50 on a share basis, but we don't report
20 that in this study.

21 Q So if we took your estimate for
22 Colorado from Exhibit 95, your report in this case,
23 for 2010, 130 million, is it your opinion that it's
24 about 65 million attributable to noncompliance by
25 businesses and about 65 million attributable to

1 noncompliance by consumers?

2 A Again, we didn't report that here
3 and didn't separately calculate the business to
4 business versus business to consumer share, so I
5 can't offer an opinion on that. But I sort of agree
6 that it's a much lower share than the 93 percent
7 that's business to business.

8 Q When you say you didn't calculate,
9 you mean for the 2009 report you didn't do that?

10 A That's correct.

11 Q The prior versions of that 2009
12 study were -- you first developed it in 2000, is
13 that correct?

14 A That's correct.

15 Q Okay. And then there was an update
16 in 2001?

17 A Yes.

18 Q And an update in 2004?

19 A That's correct.

20 Q Do you think it was in the 2004
21 report where you had a rough estimate of 50/50?

22 A I did not go back and read any of
23 those reports either in preparation for the
24 deposition or for this report, and that's just -- in
25 my head, that's sort of what I remember, that's why

1 I just -- I'm not sure at all what that number was.

2 But there have been big changes in
3 the relative distribution of e-commerce sales over
4 these years as well as we have better tuned
5 estimates on the tax ability in this latest report,
6 and that's why it's very hard to take a result from
7 an earlier study and apply it specifically to this
8 one.

9 Q Okay. Would it be possible to
10 calculate an estimate of the share attributable to
11 noncompliance by businesses from the data that are
12 available in the report?

13 A No.

14 Q Okay. Just as an -- I want to make
15 sure what piece of information may be missing. I
16 think you said, and I think the report says it's
17 about 93 percent of all e-commerce is business to
18 business?

19 A Yes.

20 Q And we have a number for total
21 e-commerce dollars, right? So we could take the
22 total dollars and apply the 93 percent to that to
23 try and figure out dollars of e-commerce sales to
24 business; is that a fair statement?

25 A It is, but the categorization

1 matters a lot here and, you know, we're using
2 Colorado's specific tax ability numbers, so the
3 averages don't apply to Colorado. We would need to
4 go in, you know, to the 51 categories of sales we've
5 used in this study, see what's taxable in Colorado
6 and apply it. You know, you can't use the aggregate
7 numbers even to get an average, much less for
8 Colorado because of the specific elements of
9 Colorado's tax structure that are included in this
10 analysis.

11 Q Okay. Is it fair to say that a
12 substantial portion of the \$130 million Colorado
13 estimate for 2010 is attributable to sales between
14 businesses?

15 A Yes.

16 Q Okay.

17 MS. SNYDER: Matt, I didn't hear
18 your question and if there was an answer, I
19 didn't hear it.

20 MR. SCHAEFER: The question was --
21 rather than --

22 (Whereupon, question and answer read back)

23 MS. SNYDER: Thank you.

24 BY MR. SCHAEFER:

25 Q So just to make sure, because that

1 sounds like I either misspoke or perhaps it was just
2 the read back, but is it fair to say that your
3 estimate of \$130 million for Colorado for 2010, of
4 that 130 million a substantial portion is
5 attributable to noncompliance by businesses?

6 A Yes.

7 Q And you are aware that some states
8 have undertaken initiatives to try to improve the
9 compliance by businesses with the use tax?

10 A Just generally aware of it, yes.

11 Q Do you have any states in mind?

12 A No.

13 Q Okay. Are you aware whether or not
14 California has undertaken any such initiative?

15 A No.

16 Q We'll mark as the next document,
17 Exhibit 106 --

18 A Just to be clear on what I know and
19 don't know about this, Harley Duncan, who was the
20 former director of the Federation of Tax
21 Administrators, and I wrote a paper for one of the
22 Georgetown Law School symposiums five years ago,
23 four years ago, on issues associated with tax
24 collection. In there, we did include some
25 information on various kinds of compliance

1 Q Would you agree with me that your
2 estimates in your report, Exhibit 95, made differing
3 assumptions than are dictated by the requirements of
4 House Bill 10-1193 with regard to uncollected -- the
5 prospects for -- strike that question.

6 Under the Colorado law, the
7 Colorado Department of Revenue has instituted a de
8 minimis seller exception, have they not?

9 A Yes.

10 Q Do your estimates in Exhibit 95,
11 your report, take into account a de minimis seller
12 exception?

13 A No.

14 Q Would you agree with me that how
15 much revenue Colorado realizes as a result of House
16 Bill 10-1193 and the regulations promulgated by the
17 Department of Revenue to implement it depend
18 directly upon the Department of Revenue's
19 enforcement practices with regard to the law?

20 A We haven't done -- or I haven't
21 done any study of this particular piece of
22 legislation and what its implications are.

23 Q Okay. But how much revenue that
24 the department -- that Colorado could realize would
25 depend directly, would it not, on the Department of

1 Revenue's enforcement practices?

2 A As a general statement, I would
3 agree with that. Again, as applied to this
4 particular legislation, it's not something I've
5 studied.

6 Q But, for example, you know that the
7 Bill itself does not require sales and use tax
8 reporting by firms located outside of Colorado; that
9 is House Bill 10-1193 does not require that
10 companies located outside of Colorado, without a
11 physical presence in the state, collect
12 Colorado's --

13 MS. SNYDER: I'm sorry, Matt, I
14 couldn't hear your question.

15 MR. SCHAEFER: Sure.

16 Q Simply, Dr. Fox, you're aware, are
17 you not, that the law at issue in this case does not
18 require or even purport to require sellers located
19 outside of Colorado, having no physical presence in
20 the state, to collect Colorado sales and use tax?

21 A Yes, I'm aware of that.

22 MS. SNYDER: Excuse me, can I have
23 the question read back and the answer, I
24 really just couldn't hear either.

25 (Whereupon, question and answer read back)

1 BY MR. SCHAEFER:

2 Q With regard to Colorado's sales and
3 use tax system, are you aware that there are a
4 number of home rule jurisdictions in Colorado that
5 are not administered by the Colorado Department of
6 Revenue?

7 A Yes, I'm generally aware of that.

8 Q And those home rule jurisdictions
9 in Colorado administer their own sales and use tax,
10 local sales and use tax system?

11 A I have never studied that, but
12 that's what I have been told, yes. Outside of this
13 case in previous times I was told that.

14 Q Your estimates for Colorado include
15 an estimate of tax collected by such home rule
16 jurisdictions, do they not?

17 A They do.

18 MR. SCHAEFER: I'm going to take a
19 short break, I may be quite close to
20 finishing.

21 THE WITNESS: Okay.

22 (Recess from 12:21 p.m. to 12:26 p.m.)

23 MR. SCHAEFER: Dr. Fox, I'd like to
24 thank you for your time, I don't have any
25 further questions for you.