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MARKETPLACE FAIRNESS: LEVELING THE PLAYING FIELD FOR SMALL BUSINESS

HEARING

BEFORE THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED TWELFTH CONGRESS

SECOND SESSION

AUGUST 1, 2012

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ONE HUNDRED TWELFTH CONGRESS

SECOND SESSION

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MARKETPLACE FAIRNESS: LEVELING THE PLAYING FIELD FOR SMALL BUSINESS

WEDNESDAY, AUGUST 1, 2012

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The Committee met, pursuant to notice, at 2:30 p.m. in room SR–253, Russell Senate Office Building, Hon. John D. Rockefeller IV, Chairman of the Committee, presiding.

OPENING STATEMENT OF HON. JOHN D. ROCKEFELLER IV, U.S. SENATOR FROM WEST VIRGINIA

The CHAIRMAN. I want to welcome our three distinguished colleagues here: the soon to be distinguished when he comes in the door, Senator Durbin; Senator Alexander, who is an old friend, and he and I were Governors together, and I wanted him to make me president of Vanderbilt and he never did—but I do love him; and Senator Enzi, who I met when he had long sideburns and was mayor of Gillette, and who I co-sponsored this bill with in 2001. So we've got some history there.

And I invite all of you, if you can, when you finish your testimony, to just come up and join us on the dais and be part of the questioning. So if that's of interest to any of you, there is a seat for you and a welcome.

This is about the legislation, the Marketplace Fairness Act, and I am pleased to join them in their efforts to get this legislation into law. I know that Senator Enzi has worked on this issue for more than a decade. And I recall that Senator Enzi's original bill on this issue was referred to this committee. That's not a macho statement. That's just a fact. And he is to be commended for his commitment on this issue.

I've always thought it was the right idea and co-sponsored that first bill with Senator Enzi, just as I am co-sponsoring his current bill. When he first introduced this bill, it was not a popular idea, and it may not be today. But I don't care. It's the right thing to do. Over time, more people have come to understand that this is an issue of basic fairness and critical to states' financial health—precarious health—not just now but in the future.

There is a growing bipartisan consensus on this, and not only here but around the country, that the Congress should address this issue. In West Virginia, we are fighting to keep our small towns vibrant. We have nothing but small towns. Our largest town is 50,000, barely, and we just keep it a little bit above 50 so we can

qualify for certain government grants. Where it actually is, I'm not entirely sure.

But we need local retailers. I'm sick of traipsing up and down our streets in our small communities and seeing all these shuttered stores where people used to do business. We need local retailers to make that happen. I believe we can have both a vibrant main street economy and e-commerce businesses.

Let's be honest. Allowing states to collect sales tax on online purchases will not stop the growth of e-commerce. Now, I'll be interested in any arguments to the contrary. But no matter where or how the purchase is made, our commerce needs the revenue from these sales to fund basic functions of state government. As I recall, when I was Governor many years ago, I think about 70 percent of the sales tax went to our school system. Now, obviously, it doesn't. I think that's right.

When we debated the Internet sales tax reform 10 years ago, Internet commerce was still in its relative infancy. Fewer people had online access, and many were reluctant to share their credit card information, for heaven sakes, with online retailers. But as the Internet has grown, so too has the consumer's confidence in Internet transactions. Millions of consumers now click and buy online with ease.

Because sales tax is not collected for most Internet transactions, consumers know how they can benefit from a 5 percent to 10 percent discount online. In fact, the mobility of cell phones allows shoppers to scan products for information. This bothers me so much. They can wander around our local stores—hardware, whatever, books—and they can sort of check things out, see what they want, and then they go buy it online. I think that's terrible behavior, it's very costly to our states, and I think it's very wrong.

Again, I think it is profoundly unfair to traditional shops. They are, after all, small businesses, and small businesses are always in peril. And they end up serving as a kind of display case for consumers who see the product in person but buy it online to avoid paying state sales tax.

State and local governments are losing billions. West Virginia loses a staggering $100 million a year. In my opinion, this revenue could be used to help, for example, in those couple of years before Medicaid expansion—of Governors who go that direction—kicks in. There's a couple of years where more money is needed from the states, and it could go to this, and it could go back to the Board of Education. It could go to lots of things. $100 million is a lot of money.

Welcome, Senator Durbin. And after you've given your testimony, if you want to come up and join us up here, you'd be welcome.

If Congress does nothing, we'll end up with states forced to raise income or property taxes to offset the growing losses of sales tax revenue, which is just a fact. That doesn't seem like the right solution to me. To be clear, this debate is not about imposing new taxes. It is not. Instead, it's just allowing states to collect taxes they are currently owed under existing law but are being systematically avoided.

Today's technology, with the tremendous advances made in recent years, makes tax collection simply cheap and reliable. In many

ways, the Internet is the perfect environment to collect sales tax because it can be automated. And our witnesses will talk to us about that.

I know there is still debate on this point, and I look forward to hearing from the witnesses about the cost that businesses will bear and why they believe that small business exemption is not enough to alleviate these concerns. So I look forward to the testimony that will be forthcoming.

And Senator Hutchison not being here, and Senator Ayotte being here, I would welcome you.

STATEMENT OF HON. KELLY AYOTTE,
U.S. SENATOR FROM NEW HAMPSHIRE

Senator AYOTTE. I thank you very much, Chairman Rockefeller, and I appreciate the opportunity to give a statement today. I know you didn't have to allow me to do that, but I'm very appreciative of that.

This proposal we'll discuss today is very critical to New Hampshire and to other states that have opted to not have a sales tax. And I really want to welcome our colleagues who are here, all three of whom I have great respect for, Senator Durbin, Senator Enzi, and Senator Alexander. So thank you very much for being here to personally introduce your bill.

Under current Supreme Court precedent, in the absence of a sufficient nexus, a state cannot reach beyond its borders to compel out-of-state vendors to collect taxes on a particular transaction. This is the result of the 1992 decision, *Quill* v. *North Dakota,* in which the Supreme Court held that requiring remote vendors to collect such taxes would place an unconstitutional burden on interstate commerce.

By circumventing the court's will, the proposal under discussion today would undermine an important limitation of the Commerce Clause, the nexus requirement. By imposing collection requirements on businesses that have no physical presence outside of their home state, I fear the proposal may erode existing protections on state sovereignty. These concerns should resonate even for the 45 states that do have a sales tax.

I am particularly concerned about how this proposal will hurt small businesses in my home state of New Hampshire. Our online retailers, for the first time, would have to collect and remit sales taxes to over 9,600 tax jurisdictions across the country. New Hampshire has no sales tax. For non-sales tax states like New Hampshire—and I know my colleague in Alaska—Alaska does not have a sales tax, either—this is simply an unfair burden for our businesses to bear. Why should New Hampshire businesses be penalized because we have chosen not to have a sales tax and, as a result of it, frankly, we do have a leaner state government.

This bill, in my view, tramples on New Hampshire's choice not to have a sales tax. This week, I received a letter from Joe Cortese, who owns NobleSpirit, an online retailer based in Pittsfield, New Hampshire. NobleSpirit sells stamps, coins, and other collectibles. And in that letter, Joe argues that under the proposal we will discuss today, quote, "Other states where I have no presence or affiliation would mandate that I have to start collecting and remitting

sales tax for items that my own state, New Hampshire, has deemed exempt."

He further points out that "I don't believe it is fair to New Hampshire businesses that another state has the authority to turn us into their personal tax collector." I couldn't agree with Joe more. And Joe's position mirrors that of many businesses across New Hampshire that I have heard concerns from about this bill.

With your permission, Mr. Chairman, I would like to submit this letter for the record.

The CHAIRMAN. Of course.

[The letter follows:]

NOBLESPIRIT
Pittsfield, NH, July 30, 2012

Hon. KELLY AYOTTE,
United States Senate,
Washington, DC.

Dear Senator Ayotte,

I write regarding the upcoming Senate Commerce Committee hearing scheduled for Wednesday, August 1, 2012 on the Internet sales tax issue. We have met previously to discuss this issue, and I sincerely appreciate your sensitivity to the small business dimension of this debate. I know it can be a challenge for some of your colleagues to understand the small business impacts of this legislation, as well as the impact on non-sales tax state sellers. As a New Hampshire small business owner that uses the Internet to market my products, I wanted to share my experience.

My story starts out in a dinner car of a Florida-bound train. While on the train, I happened to meet a gentleman who collected World War II memorabilia. Being a collector myself, I was very interested in hearing his story. The man shared with me that he just sold some items on this place called eBay and "the checks just rolled in." At this point in my life I didn't have much use for a computer, much less the Internet, but this man's story stuck with me long after we departed company.

About a year later I remembered this man's story and decided to check eBay out for myself. As a coin and stamp dealer, I was always looking for innovative ways to sell my goods. eBay and the Internet marketplace ended up being a very important tool in growing my business. I had Originally been focused on wholesale, but eBay allowed me to transition to being a retailer that goes straight to the end user. The minute I sold that first duck stamp to a stamp collector in Alaska, I knew that I was hooked and over the last 15 years I have had numerous opportunities to bring joy to collectors all around the world. After 15 years, I remain enthralled to this day by the notion that we in the United States are able to market to the world via the concept of the Internet.

Access to the global marketplace is one of the beauties of selling on the Internet. It can give a small business in a rural state, like mine, endless opportunities to reach consumers beyond the boundaries of their county, state or even country. The idea that a small business in New Hampshire could reach a customer thousands of miles away in remote Alaska is a truly amazing thing. Access to the global marketplace is no longer reserved for large corporations. With the Internet and platforms like eBay and PayPal small businesses finally have the opportunity to try and compete head to head with the big guys.

However, I am concerned that the Internet sales tax proposal currently before the U.S. Senate has the ability to diminish the amazing strides small business retailers have made through the use of the Internet. If policymakers decide to impose new sales tax collection burdens on small businesses and force them to collect and remit in 9600 tax jurisdictions nationwide, the legal, compliance and administrative costs alone would undoubtedly make it harder, and in many cases impossible, to enjoy the opportunities and benefits that come with access to the Internet marketplace.

In addition, as a New Hampshire small business, I am not required by my state to collect and remit sales tax on the goods I sell. Our great state has made a decision to be a non-sales tax state and I believe that this decision has helped drive economic activity across our state. However, I am concerned that under the current proposal, other states, where I have no presence or affiliation, would mandate that I have to start collecting and remitting sales tax for items that my own state has deemed exempt. I don't believe it is fair to New Hampshire businesses that another

state has the authority to turn us into their own personal tax collector. It seems odd to me that one state would be given that much authority over another state and I urge you to fight to protect New Hampshire's ability to protect their businesses from out of state tax authorities.

Our nation's economy is top of mind as we approach the next general election. Our small business infrastructure forms the very backbone of that economy. At a time when we are so uniquely positioned to provide our fundamental economic roots with uniquely defensible strategies, we as a nation would benefit greatly from exploring ways to foster those resources instead of permitting them to be impacted and impaired. Big Box retailers enjoy specific advantages, the scope of which is unchallenged by small business, which is exactly why they are pressing so hard to eliminate their competitive small business counterparts. If we as a nation allow that to take place we will impede our Nation's prosperity on a global scale, in both the short and long term.

Thank you for the opportunity to share my story and express my concerns with the Internet sales tax proposals currently before the U.S. Senate. I want to personally applaud you for all of the work that you have done on this issue. You have been a true champion for New Hampshire and small Internet-enabled businesses, like me, and I appreciate everything that you are doing on our behalf. If there is anything that I can do to assist you in the future on this issue, please do not hesitate to call me. Thank you again for all of your efforts and I appreciate you keeping me and the other New Hampshire small businesses in mind as the Senate Commerce Committee considers Internet sales tax policies.

Sincerely,

JOE CORTESE,
Owner,
NobleSpirit.

cc: The Honorable John D. Rockefeller IV, Chairman, Senate Committee on Commerce, Science, and Transportation

The Honorable Kay Bailey Hutchison, Ranking Member, Senate Committee on Commerce, Science, and Transportation

Senator AYOTTE. Thank you.

One final point: Why would we enact legislation that would increase the cost of online commerce and also will cost consumers more? Ultimately, it will be the consumers who pay for the cost of this. By imposing onerous collection requirements, this bill would be a disincentive for retailers to embrace the e-commerce model.

I understand that there are a number of witnesses here today who will have a different viewpoint. I certainly look forward to hearing from them. And I thank the Chairman for the opportunity to give a statement today.

The CHAIRMAN. Thank you, Senator.

And now looking at these three distinguished senators, I've settled on the distinguished gentleman in the middle, the senator from Wyoming, remembering his long sideburns from many years ago.

Senator Enzi, you're welcome.

STATEMENT OF HON. MICHAEL B. ENZI, U.S. SENATOR FROM WYOMING

Senator ENZI. Thank you, Mr. Chairman, for holding this hearing and also for your visit to Wyoming at that time. I do have that picture that has you in a little bit different dress than you wear right now, too. It was an enjoyable time having you come out to take a look at our coal mines in Wyoming, and I've been to West Virginia and looked at your coal mines, too.

But I appreciate you holding this hearing today. It's an important issue for retailers, for state and local governments, and for consumers. State and local governments, particularly, have been

hit by the fact that we don't do earmarks anymore, and we've run out of money so we can't do the projects even in a grant form that we've done before. So they're looking for a way to be able to continue to sustain their state.

So I've been working on this sales tax fairness issue since I came to the Senate in 1997. As a former small business owner, it's important to level that playing field for all retailers, whether they're in-store, catalog, or online, and so an outdated rule of sales tax collection doesn't adversely affect those small businesses and main street retailers.

I remember, as a state legislator in Wyoming, we never passed a law that burdened the people who pay the property tax, who hire the residents, who participate in the community, who are in all the events, and then tell the businesses from out of state that we're going to give them a special deal so that they don't have to collect the money. We'd take money from the local community, but those from out of state wouldn't have to do anything in return for the services that our consumers are getting as a result of the tax.

So we never intended to give those out-of-state businesses an advantage over those businesses that are a part of the community. Yet that's exactly what we are facing unless Congress allows the states the opportunity to fix it, if they so choose. My original versions—and I've had a number of different versions of this bill—were considerably more complicated until Senator Alexander suggested to Senator Durbin and I, who had been working on the previous versions, that this should be a states' rights bill and be considerably simpler, and it is.

For the past 20 years, states have been unable to enforce their own sales and use tax laws on sales by out-of-state catalog and online sellers due to the 1992 Supreme Court Quill decision, *Quill* v. *North Dakota.* In 1992, the Supreme Court stated that the Congress needs to decide how to move forward. In other words, the Supreme Court challenged us to do a law. I strongly believe that now is the time for us to act.

Most customers do not realize that when they buy something online or order something from a catalog from a business outside of their own state that they still owe the sales tax. And a lot of the sales are small enough that they don't even realize they've made the purchase. So this isn't a new tax. This is a tax that's already owed. The bill doesn't tax Internet use. The bill doesn't tax Internet services. The bill doesn't raise taxes. It collects what's owed by the purchasing individual.

Last year, Senator Durbin, Senator Alexander, Senator Tim Johnson and I introduced with six of our other colleagues—half Republican, half Democrat—the Marketplace Fairness Act to close the 20-year loophole that distorts the American marketplace by picking winners and losers and by subsidizing some businesses at the expense of other businesses and subsidizing taxpayers at the expense of other taxpayers. All businesses in the retail sales and all consumers in their purchases should be treated equally and fairly.

I want to provide you with some highlights of the Marketplace Fairness Act. It does allow states, if they choose to do so, to have out-of-state retailers collect the sales tax that's due on all sales, whether they're online, catalog, or in-store sales. The legislation

would streamline the country's more than 9,000 diverse sales tax jurisdictions, and it provides two options by which states can begin collecting sales taxes from online and catalog purchases. But those are voluntary options that would allow them to collect the sales taxes if they choose.

Now, the bill also carves out small businesses so they're not adversely affected by the new law by exempting businesses with less than $500,000 in online or out-of-state sales from collection requirements. This small business exemption will protect small merchants and give them time to get started.

Don't let the critics get away with saying this kind of simplification cannot be done. In the early 1990s when the Quill decision was handed down, the Internet was still in diapers and cell phones came in bags and looked like bricks. Now, the Internet permeates just about every part of our life and it's time to stop treating businesses that rely almost exclusively on that like a novelty.

Cell phones now have Internet capability. Software, computers, technology—they've all advanced at an exponential pace. And the different rates in various jurisdictions are no problem for today's software programs.

I want to publicly commend Senators Durbin and Alexander for taking a leadership role in this and looking for some of the flaws that were in the bill and helping us to eliminate them, because this is a really important policy issue. Marketplace fairness is simple. It's about states' rights and it's about fairness. At a time when states' budgets are under increasing pressure, Congress should give state and local governments the ability to enforce their own laws. This will give states less of an excuse to come knocking on the Federal door for handouts, and it will reduce the problem of federally attached strings and give the states a choice to reduce property taxes or other taxes.

So I strongly encourage my colleagues to support S. 1832, the Marketplace Fairness Act, and get it enacted in public law, hopefully, this year.

The CHAIRMAN. Thank you, Senator Enzi.

And then Senator Durbin to be followed by Senator Alexander.

STATEMENT OF HON. RICHARD J. DURBIN, U.S. SENATOR FROM ILLINOIS

Senator DURBIN. Thank you very much, Mr. Chairman. It's an honor to be with you today. I do want to thank Mike Enzi. I picked up this banner when Byron Dorgan retired. This is something that he worked on with Senator Enzi over the years.

But I think Mike and I would both give special credit to Lamar Alexander. He stepped in, helped us through some complicated issues, simplified them, and made this much easier to explain and implement.

So, Lamar, thank you. Mike and I appreciate very much all the help that you've put into this.

I want to go directly to Senator Ayotte's question, because I think she really has raised what is a concern expressed by many. And let me say at the outset: if you don't have a sales tax in New Hampshire or in Alaska, this bill will not impose one penny of sales tax obligation on any resident of New Hampshire, Alaska, Or-

egon, or any other state without a sales tax. Not a single resident of that state has to pay an additional penny in sales tax, period. Whatever your state law is, that governs.

The second point I want to make is one that she addresses, and I think it's very important. What kind of burden are you putting on NobleSpirit? I don't know what they sell.

Senator AYOTTE. Stamps and collectibles.

Senator DURBIN. What kind of burden are you putting on a business like NobleSpirit that wants to do business in other states? Well, right now, there are burdens in every single state represented here today.

Senator Isakson, if somebody wants to come into Georgia and do business, it's probably the same as Illinois. You have to register with the state that you're there, where you can be served with process, and, once there, follow Georgia law as it applies to your business. That happens in every single state in the Union.

And what we're saying here is that if NobleSpirit wants to do business in Illinois and open a storefront to sell stamps, it's pretty obvious what they have to do. There's a long list of state requirements in each and every state. So what if they want to do it remotely? What if they want to sell their product electronically or by catalog? What obligation do they have in the state of Illinois or in the state of West Virginia? That's what this addresses.

First, there's a small business exemption. If they're selling Grandma Ayotte's Apple Butter, that famous New Hampshire apple butter, and they're selling less than $500,000 worth——

Senator AYOTTE. That's maple butter.

[Laughter.]

Senator DURBIN. Sorry—maple butter—and selling less than $500,000 in value in a given year, they're exempt. And we're ready to talk about what the right level of small business exemption is. Let's get that right. Let's find something we all agree on.

Second, does this mean you have to go out and buy a new computer network and software and hire some technology manager? No. What we've said here is if you're not under the streamlined version, which has already been in the law for a number of years, we're setting up a simple access for retailers selling online or by catalog so that, when they punch in Senator Wicker's address in Mississippi, they know automatically how much has to be added to the bill, because the sales tax obligation is there.

And who do they remit that money to? One agency in the state. So, frankly, it's going to be as simplified and direct as possible at the end of the day.

So it comes down to this. It is about fairness, marketplace fairness. Each and every one of us represents a brick-and-mortar businessman or woman who came up the hard way with their own entrepreneurial determination and said, "I'm going to make a go of it." Ninety-five percent of them fail. But the 5 percent that make it really are the backbone of the American economy.

Right now, they're facing unfair competition, unfair competition in my state—maybe not so much in New Hampshire with no sales tax—when their competitors online are not collecting sales tax and they have to collect it. They collect it, obviously, to keep the lights on in the streets, the traffic functioning, and the police and fire-

men, and all of the rest that we expect. So at the end of the day, this is about fairness for all businesses across the board.

And let me go to the point that Senator Enzi made, which I probably should have addressed at the beginning. It is not a new tax. It is a question of collecting a tax already owed.

A couple of years ago, my bookkeeper, when she was putting together our tax returns, which I file with my disclosure each year, said, "Well, on your state tax return, are you going to pay the sales tax that you owed for your Internet purchases?" I said, "I didn't think of that." She said, "It's an obligation under the law." So you'll not be surprised, since I'm announcing it, to know that I paid it.

[Laughter.]

But you may be surprised to know that fewer than 5 percent of Illinoisans who make purchases on the Internet actually pay what they already owe under the law. This bill says no new tax. We're just collecting the tax already owed.

It's like enforcement. If you happen to believe that people who are evading taxes now, illegally evading taxes now, should not be required to pay them, then I can understand the logic of your argument that this is a new tax. But if the tax already exists, and we're just talking about compliance and collection, that's all this bill does. And I think it's an important thing.

I won't tell you what it means in terms of revenue for each state. I think you each know it—$23 billion nationwide. For many of us, our states are struggling with their budgets. I take a look at those who have announced support for this bill: 240 business and labor organizations, eight Democratic Governors, 13 Republican Governors, including Governor Quinn, Democrat from Illinois; Governor Christie, Republican from New Jersey; Governor McDonnell, Republican from Virginia; Governor LePage, Republican from Maine; and Governor Daniels, Republican from Indiana.

There's bipartisan support not only at this table but across the country. And I hope this committee will support the bill as well.

The CHAIRMAN. Thank you, Senator Durbin.

Senator Alexander, we look forward to your testimony.

STATEMENT OF HON. LAMAR ALEXANDER, U.S. SENATOR FROM TENNESSEE

Senator ALEXANDER. Thanks, Mr. Chairman. Thanks for inviting us. And a salute to Senator Enzi and Senator Durbin for doing what would be a Washington, D.C., miracle. They've come up with an 11-page bill about a two-word issue, and the issue is, in my view, states' rights.

The longer I've been in Washington—and I've tried to be here long enough to be vaccinated but not infected over the years—the more I've come to the conclusion that the two biggest problems here are, one, that we spend money we don't have, and two is that we make a lot of decisions here that ought to be made at home by families, communities, and states.

I have a conservative Republican Governor and a very conservative Republican Lieutenant Governor and a very conservative Republican legislature, who represent a lot of conservative Tennesseans. And they believe that it is their business, not ours, to decide whether they should collect taxes from everybody who owes it

in Tennessee or from just some of the people who owe it, or whether we should give a 10 percent tax break to out-of-state businesses but not to in-state businesses.

They may make a wrong decision from our point of view about that. But in our Constitutional 10th Amendment Federal system of government, states have a right to be wrong.

We're talking about this. If I buy a TV set from the hardware store, the hardware store collects the sales tax and pays it to the state. If I buy a TV set from a catalog, I still owe the tax, but the catalog owner doesn't collect the tax so it's not usually paid. So we're talking about really whether—it's like a game we used to play when we were kids—"Mother, May I?"—whether Washington will allow the people of Tennessee to elect Governors and legislators who will make the decision about whether to collect taxes from everybody who owes it or just some of the people, and whether to treat all businesses in the same way.

We don't have to make that decision. The only decision we have to make is whether we respect the right of states to make that decision for themselves, which is why I say it's about two words, states' rights. It's not a new tax. In fact, as Governor Jeb Bush, former Governor Jeb Bush, said, he thinks many of the states will use the extra revenue collected, when you collect from everybody who owes it, to lower rates. I'm almost certain we'll do that in Tennessee.

It's not an Internet tax. We have a Federal moratorium on Internet taxes. That's very important. We have a Federal law that puts a moratorium on Internet taxes, and it's not a Washington mandate. In fact, it's just the reverse. If I were to ask the question: What does Al Cardenas, the Chairman of the American Conservative Union, and Governor Chris Christie and Governor Jeb Bush and Governor Mitch Daniels and Governor Snyder of Michigan and Governor Corbett of Pennsylvania and the Governor of Maine, who is sometimes called a Tea Party Governor, and even William F. Buckley—what do they all have in common, they're conservatives, they're Republicans, and they all support this legislation.

Mr. Buckley wrote about it before he died, this principle. I'd like to put in the record some of the things they said, including Governor LePage saying, "Passing this bill would give thousands of small Maine businesses a real boost. Federal policy now gives some out-of-state corporations an unfair advantage over other Maine retailers."

Al Cardenas describes this instance as an area where prejudice is most egregious. It's unfair. Mike Pence: "I don't think Congress should be in the business of picking winners and losers." Inaction by Congress today results in a system today that does pick winners and losers. This is not the Americans for Democratic Action that are making these comments. This is an honor roll of conservative Republicans who believe in making decisions at home instead of in Washington. They believe this is a matter of states' rights.

The question has been raised about whether this puts a burden—the Supreme Court said 20 years ago that states couldn't do this. It was too much of a burden. But they invited Congress to solve the problem, to do what we're proposing to do today. It will be just as easy today to collect the sales tax online as it will be over the

counter. You just take your credit card—it has your address on it. The software in your machinery will add the tax. The software will pay the state. You won't have liability. You only have one audit a year from the state. That's the system that will be set up here.

My conservative Governor, Lieutenant Governor, and legislature don't believe I get any smarter each week when I fly to Washington and any dumber when I go home. They don't want me making decisions up here that they're elected to make by the people of Tennessee. They're perfectly capable, they believe and I believe as well, of deciding whether or not to collect taxes, their taxes already owed from the people who already owe it, from some of them or all of them, or whether to prefer some businesses over others.

They might make a wrong decision. They have a right to do that in our American system of government. But if we give them this structure and authority, I'm pretty sure that they will collect tax from everybody who already owes it, that they will use most of the revenues to lower our tax rates in Tennessee. And I'm pretty sure that if we pass this bill and they're allowed to act that it will eliminate for the foreseeable future the possibility that Tennessee will ever have to have a state income tax, which is the one thing we really don't want in our state.

Thank you very much for the invitation to be here.

The CHAIRMAN. Thank you very much, Senator Alexander.

And I will repeat, Senator Durbin, before you came in, any of you—and I believe that Senator Alexander may do this—and I would welcome you and Senator Enzi just coming up on the dais here and listening to the testimony and asking questions. If it's true that you're busy, you probably won't do it.

Senator ENZI. I appreciate it, but I'm going to have to go to some other meetings. Thank you for the offer.

The CHAIRMAN. Thank you both, all of you.

Senator, you can just come forward here.

I'd like to call forward now our witnesses.

And, Senator Alexander, do you insist on being the most junior Republican?

Senator ALEXANDER. I kind of like it.

[Laughter.]

The CHAIRMAN. You do? OK.

Mr. Paul Misener, who is Vice President for Global Public Policy, Amazon.com; Steve Bercu, Chief Executive Officer of BookPeople; Scott Peterson, Executive Director of the Streamlined Sales Tax Governing Board; and Steve DelBianco, Executive Director of the NetChoice Coalition.

STATEMENT OF HON. ROGER F. WICKER, U.S. SENATOR FROM MISSISSIPPI

Senator WICKER. Mr. Chairman, did we get all of the quotes that Senator Alexander offered submitted to the record by unanimous consent? Because I do want them in the record.

The CHAIRMAN. They're in the record by virtue of him having said them. But we can make it more formal.

Senator WICKER. I think there were other quotations that he didn't read. [Please see pp. 164–166, "Conservatives Support E-Fairness"]

Senator ALEXANDER. Mr. Chairman, if I may ask consent to include this in the record.

The CHAIRMAN. That will be in the record.

Mr. Misener, we'll start with you.

STATEMENT OF PAUL MISENER, VICE PRESIDENT FOR GLOBAL PUBLIC POLICY, AMAZON.COM

Mr. MISENER. Thank you, Chairman Rockefeller and members of the Committee, for inviting me to testify. I greatly appreciate it.

Amazon has long supported an even-handed national framework for state sales tax collection, and only Congress may create this framework. To this end, Amazon believes that Congress should authorize the states to require out-of-state sellers to collect sales tax already owed, and we strongly support enactment of S. 1832 from Senators Enzi, Durbin, and Alexander.

Mr. Chairman, the last time I testified before your committee on this particular topic was 9 years ago. And much has changed since then, including the introduction of S. 1832 with its several innovations and the development of advanced, widely available sales tax collection services. Also since then, most of the important questions around this legislation have been answered.

For example, is it a new tax? No. It authorizes enforcement of existing state laws. Does it impose burdens on states? No. To the contrary, it protects states' rights to make policy. May the states take care of this on their own? No, only may Congress. Does it require states to join the Streamlined Sales Tax Project? No. States have the choice of joining the project or making other stipulated simplifications.

Does it violate the ATR pledge? No. That pledge only applies to income tax. Is it taxation without representation? No. Those paying the tax are represented in the state doing the taxing and the Supreme Court holds that constitutional due process is met when requiring interstate sellers to collect. Does it harm tax competition? No. Taxpayers still may choose low-tax states.

Does it represent more Federal involvement in state tax matters? No. To the contrary, by inaction, Congress continues to deny the states' rights to make policy choices, like low income tax rates or no income tax at all. Only by passing this legislation would sales tax decisionmaking devolve to the states.

Asked another way, does Federal action on this issue promote centralization of power? No. Passing this legislation will decentralize policymaking to the states and localities. So is it constitutional? Yes. The Supreme Court has invited Congress to act. Does it restore federalism? Yes. As Justice Scalia has pointed out, dormant commerce clause decisions like *Quill* render superfluous part of the 10th Amendment.

Do the states want it? Yes. The long list of state government supporters, including many prominent Republican Governors, highlights this fact. How about voters? Do they want it? Yes. A recent national survey by a prominent Republican pollster showed that 69 percent of registered voters support this legislation; 67 percent of Republican registered voters support it; and even among conservative registered voters, 61 percent support it.

So what important questions are left unresolved? There is really only one. Would the legislation impose significant administrative burdens on small sellers, including small businesses? For five key reasons, we can be confident that this legislation would not impose a significant administrative burden on small sellers, including small businesses.

First, we shouldn't lose sight of the fact that this legislation clearly would help, not burden main street businesses selling locally. Second, the legislation would restore the revenue and jobs lost by small online advertisers, who have suffered under counterproductive state laws enacted over the past 4 years.

Third, S. 1832 specifically protects small interstate sellers. The bill outright exempts sellers with less than $500,000 per year in interstate sales, and this is well over 99 percent of online sellers, including the occasional sellers and small businesses that sell through eBay and Amazon.

Fourth, even for medium and large businesses, those with interstate sales over $500,000, third-party sales tax collection services, like those provided through eBay or run on Oracle, facilitate compliance. A key point is that sellers already are collecting with the help of third-party service providers like Avalara. And, last, S. 1832 provides for sales tax simplifications and other provisions that will make it even easier for third-party service providers to assist sellers and the states.

Mr. Chairman, this issue has been considered by Congress for over a dozen years. Advanced sales tax collection services are available today that weren't available even just a few years ago. The sponsors of S. 1832 have drafted the bill so that it addresses all the important questions that have been raised in over a decade of discussions, including with respect to small volume interstate sellers.

Respectfully, therefore, I ask that you support enactment of S. 1832, and I look forward to your questions. Thank you.

[The prepared statement of Mr. Misener follows:]

PREPARED STATEMENT OF PAUL MISENER, VICE PRESIDENT FOR GLOBAL PUBLIC POLICY, AMAZON.COM

Thank you, Chairman Rockefeller and Ranking Member Hutchison, for inviting me to testify. Amazon has long supported an even-handed nationwide framework for state sales tax collection, and only Congress may create this framework. To this end, Amazon believes that Congress should authorize the states to require out-of-state sellers to collect the sales tax already owed, and we strongly support enactment of S. 1832, a bipartisan bill already before the Senate.

Mr. Chairman, at the Philadelphia Convention, which the Founders convened principally to consider the challenging issue of trade among the states, Congress was granted exclusive power to regulate interstate commerce. Exactly two centuries later, in 1987, North Dakota challenged this exclusivity and, following five years of litigation, the U.S. Supreme Court held in *Quill* v. *North Dakota* that requiring out-of-state sellers to collect tax would impose an unconstitutional burden on interstate commerce. Importantly, the *Quill* court also invited Congress to act, saying that this issue is "not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve."

Far from an e-commerce "loophole," the constitutional limitation on states' authority to collect sales tax is at the core of our Nation's founding principles. For this reason, Amazon has steadfastly opposed state attempts to require out-of-state sellers to collect absent congressional authorization. We believe that, instead, Congress should enact S. 1832, the Marketplace Fairness Act, to authorize the states to re-

quire out-of-state retailers to collect sales tax at the time of purchase and remit those taxes on behalf of consumers.

Mr. Chairman, Congress should enact S. 1832 to protect the states' rights, address the states' fiscal needs, and level the playing field for all sellers.

Congress should act to protect the states' right to make their own revenue policy choices. For example, some states have chosen to eschew personal income tax, making them particularly vulnerable to uncollected sales tax. The right of any state to make such a policy choice *effective* should be protected by allowing states to ensure that sales and use taxes already owed are collected in a uniform manner, including when sales are made across state lines. And doing so would not violate pledges that are limited to questions of income tax rates and deductions.

The states' financial needs should be addressed. The states face serious budget shortfalls. Adopting sales tax collection reform is a way for Congress to help the states without spending Federal funds. S. 1832 would simply allow the states to collect more efficiently the billions of dollars of uncollected sales/use tax revenue already owed.

Fairness among sellers also should be created and maintained. Sellers should compete on a level playing-field. Congress should not exempt too many sellers from interstate collection, for these sellers will obtain a lasting un-level playing field advantage versus Main Street and other retailers. Congress should rectify the current imbalance and avoid a future imbalance.

Mr. Chairman, the facts in the *Quill* decision arose a quarter of a century ago, and the Supreme Court's decision was rendered a year before the World Wide Web was invented. With today's computing and communications technology, widespread collection no longer would be an unconstitutional burden on interstate commerce, and Congress feasibly can authorize the states to require all but the smallest volume sellers to collect. Much attention has been paid to the size of a "small seller exception" threshold in Federal legislation—and rightfully so. Such a threshold, which would exempt some sellers from any collection requirements, must be kept low to attain the objectives of protecting states' rights, addressing the states' needs, and creating fairness among sellers.

In this context, several kinds of small volume sellers must be considered. Foremost are the Main Street small business retailers who, unless the small seller exception threshold is kept very low, will forever face an un-level playing field compared to a newly-created exempt class of out-of-state sellers. Next are the online advertising affiliates, tens of thousands of whom have lost jobs or income as the result of ineffective, counterproductive sales tax laws recently enacted in many states. Congressional adoption of reform legislation would immediately restore the lost jobs and income by creating a national framework for state sales tax collection.

Small volume *online* sellers have received much of the attention, and not without reason. No one wants these sellers to shoulder alone additional burdens compared to those faced by the small business retailers who already collect sales tax in our local communities. Yet no one should want these online sellers to have a newly-created un-level playing field advantage over small Main Street businesses, and no one should want government to pick business model winners and losers this way.

The consequences of the threshold level are significant, because a surprisingly large fraction of e-commerce is conducted by smaller volume sellers. According to research commissioned by Amazon, only one percent of online sellers sell more than $150,000 per year. In other words, the $500,000 threshold in S. 1832 would exempt well over 99 percent of online sellers.

Fortunately, today's computing and communications technology will readily allow all but the smallest online sellers to collect and remit tax like Main Street retailers. Large volume online sellers already have and use this technology. Amazon, for example, collects tax on sales to consumers in states where our retail businesses have nexus. And the online arms of large multichannel brick and mortar retailers collect in the states where they have retail stores. Quite obviously, state sales tax can be collected across state lines, and the technology is not limited to large sellers. Rather, service providers also make the technology available to medium and small volume sellers. Thus, collection is either *by* sellers or *for* sellers. There are many service providers already: ADP, Avalara (which works with eBay), and FedTax, for example. Amazon also helps third party sellers by providing sales tax collection services to them, and we are committed to expanding these services.

In conclusion, Mr. Chairman, Congress may, should, and feasibly can attain the objectives of protecting states' rights, addressing the states' needs without Federal spending, and leveling the playing field for all sellers. Amazon is grateful for the opportunity to submit these comments, and we look forward to working with you and your colleagues in Congress to enact S. 1832.

The CHAIRMAN. Thank you very much, Mr. Misener.

And we'll go on now to Mr. Bercu, and I'll repeat that you are the CEO of BookPeople.

STATEMENT OF STEVEN BERCU, CEO AND CO-OWNER, BOOKPEOPLE

Mr. BERCU. Thank you, Mr. Chairman, for inviting me here to present my views on the Marketplace Fairness Act today.

My name is Steve Bercu, and, as you said, I'm the CEO and Co-owner of BookPeople, an independent book store in Austin, Texas. I employ about 100 people. My store is a general interest, large format store. And, parenthetically, two members of this committee have appeared at my store to sign copies of their books—Senator Hutchison twice and Senator Kerry once.

I'm in favor of this act. I'd like to share with you just a little about how sales tax collection impacts my small business. Online retailers, as the chairman pointed out, encourage behavior that has been called show-rooming, in which consumers spend the time and energy of brick and mortar stores to inform themselves about products, and then purchase those products online to avoid paying the sales tax due for those purchases.

I've had the misfortune to observe this behavior in my store many times. But my store is a small ticket item store. My friends who have large ticket item stores will go apoplectic about this. They spend many hours a day explaining every aspect of cameras, musical instruments, jewelry, electronic gadgets, and more, only to have the consumers at the end of the day tell them that they are going to buy these items online to attempt to avoid paying the sales tax that is due for those purchases. My friends lose millions of dollars a year in sales in this manner.

We can all compete on price, and all of us can actually compete on any offer that's made on the Internet. But what none of us can do who have a brick and mortar store is sell without collecting sales tax. This Act protects small, online retailers. As mentioned, sellers who sell under $500,000 in annual online sales would be exempted from the Act. BookPeople would be exempted from the Act under its present provisions.

However, I will tell you that BookPeople already collects in every state that has sales tax by simply using currently available software. We do so because it's the right thing to do, and also because none of my books can arrive at any remote location without using public roadways and public services in those remote locations. Everybody is the same with regard to this.

I do not feel burdened, and I doubt anyone else who is in my position would feel burdened by doing our small part to help maintain those services that are instrumental in the operation of our businesses. The Act's requirement that states simplify their tax laws should remove any major burden a small retailer has to deal with the tax issues. I can send a package across the globe with a simple table of shipping costs. I should be able to handle a little sales tax.

As pointed out by Mr. Misener, collecting sales tax is simply not that difficult. By typing in a shipping address, a customer already has given the online retailer the exact information necessary to col-

lect the appropriate tax. The calculation takes a nanosecond. Small, truly small sellers, will be exempt. But remember that many small sellers also sell the majority of their products through eBay, Amazon, and others. And those companies do have the ability to collect and remit the appropriate sales tax, and they offer that service to their sellers.

Collection has become radically simpler with new and cheaper software. Combined with a streamlined process, there is simply no legitimate excuse for Congress to be treating some retailers differently than others, to be picking winners and losers in the marketplace.

This Act is not a new tax. Texas has done its part to attempt to remedy this situation, but it's only a partial solution in Texas. And Texas and other similarly situated states need Federal help. We need a Federal solution. As pointed out, the estimated revenue loss by the states approaches $23 billion. I certainly believe that most Americans would consider that to be a sum worth taking congressional time to resolve and make this situation clear, fair, and complete.

And for all those reasons, I certainly believe that this Act will create jobs. It will help retail. It will help our states. It will help consumers stop being scofflaws. And because the free market deserves fair competition, I urge you to support the Marketplace Fairness Act.

And, by the way, if anyone has a book to promote, please get in touch. I'll be glad to get you a signing in Austin, Texas.

[The prepared statement of Mr. Bercu follows:]

PREPARED STATEMENT OF STEVEN BERCU, CEO AND CO-OWNER, BOOKPEOPLE

Chairman Rockefeller, Ranking Member Hutchison, and Members of the Committee: Thank you for inviting me to present my views on the Marketplace Fairness Act. I hope to be able to give you an insight into the day-to-day impact of collecting sales tax, both in-store and for remote sales online.

My name is Steven Bercu, CEO and co-owner of BookPeople, an Austin, Texas, independent bookstore that has been in business since 1970. I employ about 100 people, with some slight seasonal variations. My store is a large format, general interest bookstore that hosts numerous community events, including about five author signings per week. Parenthetically, two members of this Committee have appeared at my store to sign copies of their books, Senator Hutchison (twice) and Senator Kerry. I am actively involved with both independent retail and the book world, serving as Vice President of the American Booksellers Association, Vice President of the American Independent Business Alliance, Founder and President of the Austin Independent Business Alliance, and as a Board Member of the Texas Retail Association.

I am in favor of the Act. There are many reasons why I urge you to support it.

The Act will end the unfair advantage online retailers have over traditional stores and level the playing field.

Currently, many online retailers are exercising a business model that encourages tax avoidance by consumers as the online retailers fail to collect and remit sales tax. This provides them with an unfair advantage over brick-and-mortar stores as traditional Main Street stores must collect sales tax at the point of purchase every day (and for orders they take via their e-commerce sites). As a result, remote online retailers receive a government-sanctioned price advantage of up to 10 percent in many states. Furthermore, as well as tax avoidance, online retailers encourage a behavior that has been called "showrooming," in which consumers spend the time and resources of brick-and-mortar stores to inform themselves about products, and then make their actual purchases online to avoid paying the sales tax. I have had the misfortune to observe this in my store many times; but what is somewhat discouraging in a small-ticket environment like mine becomes cause for apoplexy in big-

ticket worlds. Peers of mine have spent hours explaining every aspect of various cameras and other electronic gadgets only to have the customer tell them they intend to buy online to save the hundreds of dollars due in sales tax. A friend with a jewelry store tells me he loses over $2 million per year in sales to the Internet to avoid sales tax. We can all compete on price and match any price offered online, but we cannot sell without collecting the sales tax. This Act would level that playing field.

The Act will allow for free markets to pick and choose winners, as opposed to the government.

America is built on a free-market economy that encourages business competition. By allowing some businesses to avoid collecting sales tax while others are required to do so, the government is effectively picking winners and losers in the marketplace. I do not believe the government should be in the business of picking winners and losers in the marketplace, but so long as the government allows remote retailers to work at this unfair advantage, that's exactly what is happening. Nobody likes paying or collecting sales taxes, but everyone should be playing by the same rules. It makes no sense to promote tax avoidance for some sales while taxing the rest. A sale is a sale no matter where it takes place.

This bill will save and create jobs.

The approximately 1,600 member stores of the American Booksellers Association who operate in approximately 2,000 locations nationwide generate annual sales of approximately $1 billion. When those bookstores, and small businesses just like them, lose sales to out-of-state, online-only retailers due to an unfair competitive advantage, it threatens jobs nationwide and damages the very retailers that currently create millions of jobs everywhere. An economic impact study conducted in Texas by Angelou Economics, an economic development consulting firm, showed that more than 13,000 jobs would be created annually in Texas alone as a result of collecting the sales tax from online-only retailers, and more than 9,600 of these jobs would be created in the retail sector. In addition to the $774.4 million in sales taxes that would be collected in Texas as a result of collecting the sales tax from online-only retailers, nearly $400 million more in local and state tax revenues would be generated annually throughout the state (figures from Susan Combs, Texas Comptroller of Public Accounts). These numbers derive from conservatively estimating what the thousands of Texas businesses that employ about two million people would generate if they only added 0.5 percent to their payrolls to handle the increase in business to be expected when the approximately ten percent competitive disadvantage they suffer is removed. We will be able to track those gains to some degree over the coming year now that the largest online retailer has begun to collect sales tax for Texas sales.

Collecting sales tax is good for local economies.

BookPeople participated in a landmark economic impact analysis in 2002. The study showed that shopping at locally-owned businesses provides 3.5 times the economic impact as shopping at chain retail. Shopping online at remote Internet retailers has *no* economic impact locally. This Act would help remedy this unfortunate situation.

It is well known that recycling money within a community causes what economists call a "multiplier" effect as the money recirculates within the community and its value is "multiplied" at each subsequent use. Since 2002, numerous other economic impact analyses in cities across the country (Chicago, San Francisco, Grand Rapids, Salt Lake City, etc.) have confirmed these findings. These and more studies can be found at *www.civiceconomics.com,* the website of the economists who did most of these studies, under their "library" tab.

The Act is not a new tax.

Under existing law, tax on these sales is due. The Act simply defines who is liable to collect an existing tax, as consumers already owe use taxes on purchases. However, as most state comptrollers will tell you, unless you collect sales tax at the point of purchase, it is very hard (impossible) to collect. The Act provides an even-handed solution to sales tax collection that would require online-only retailers to play by the same rules as every other business. It provides states with the clear authority to require retailers to collect sales tax.

It is sometimes argued that the Act would authorize states to impose a new tax with complex burdens on businesses without a storefront, in that it would impose obligations on out-of-state businesses. Just because some online retailers do not currently collect sales tax does not mean the tax is not due. Online retailers are simply shifting the burden to report and remit the tax to consumers, knowing that the

overwhelming majority will never declare and remit the tax. Undoubtedly, the Act contemplates that retailers would be obliged to collect sales tax for another jurisdiction, but the collection is not difficult and the Act simplifies the process of remitting the collected revenues. These days there are numerous services that can manage as much of the sales tax collection process as a retailer would want from simply supplying the data necessary (the tax rates) to becoming the backend of your website and handling the entire process.

The Act allows states to decide whether or not to collect sales and use taxes already owed under state law.

This legislation is not a government mandate. Under this legislation, it is the states that decide whether or not they will collect sales tax on online sales. If they do choose to collect, they can do so by either becoming a member state of the Streamlined Sales and Use Tax Agreement, or they can adopt minimum simplification requirements.

The Act preserves states' rights.

The Marketplace Fairness Act would help states enforce their own tax laws and collect millions of dollars in lost revenue from online retailers that do not collect sales tax.

The Act protects small online retailers.

Sellers with less than $500,000 in annual online sales would be exempted from collecting sales and use taxes, so they are not overly burdened by tax collection requirements. BookPeople would be exempted from collection under the Act, but BookPeople already collects for every jurisdiction that has a sales tax using some of the software mentioned above. We do so because it is the right thing to do and because our books can only arrive at a remote location by using public roadways and services in those remote locations. That is true for everyone. It is fatuous to argue that we are burdened by being asked to help maintain the services necessary to the functioning of our businesses.

The Act requires states to simplify their tax laws if they do not participate in the Streamlined Sales and Use Tax Agreement. Those provisions remove any major burden a small retailer might face. If I can send a package across the globe using a simple table of shipping costs, then I should be able to handle a little sales tax.

Collecting sales tax will not be difficult.

The simple fact is, collecting sales tax is not all that hard. Those who trot out this red herring are doing so solely to keep the special tax treatment they currently enjoy. By typing in a shipping address, a customer has already given the online retailer the exact information they need to collect the appropriate sales tax—the calculation will happen in a nanosecond.

Whether a state is part of the Streamline Sales Tax and Use Agreement or not (Texas is not) a common set of definitions of what is or is not taxable, along with a single collection authority for the entire state, will make collection quite simple for online retailers. Truly small sellers will be exempt, but remember that many small sellers also sell the majority of their products through eBay, Amazon, Best Buy, and others. Those companies all have the ability to collect and remit the appropriate sales tax, and all offer that service to their sellers.

This isn't that hard. The truth is that collection has become radically simpler with new and cheaper software. Combined with a streamlined process, there is simply no legitimate excuse for Congress to be treating some retailers differently than others.

The Act does NOT add a penny to the Federal deficit.

This legislation does not impose funding requirements on the Federal Government. In fact, it should have a positive impact on government since all extra revenue to the states should reduce their reliance on Federal funds (and their requests). It is argued that the anticipated revenue does not justify whatever might be required to collect it since e-commerce generates only about 1 percent of total tax revenue. That reasoning makes anything irrelevant. The estimated revenue lost by the states is around $23 billion. I think that most Americans would think that is enough to worry about.

Conclusion

For all the reasons above and because the Act will create jobs, help retail, help our states, help consumers stop being scofflaws, and because the free market deserves fair competition, I urge you to support S. 1832.

The CHAIRMAN. Thank you very much, sir.

We go now to you, Mr. Peterson.

STATEMENT OF SCOTT PETERSON, EXECUTIVE DIRECTOR, STREAMLINED SALES TAX GOVERNING BOARD

Mr. PETERSON. Thank you, Chairman Rockefeller and members of the Committee. My name is Scott Peterson. I am the Executive Director——

The CHAIRMAN. And you're the one who can answer all the questions about paperwork.

Mr. PETERSON. Thank you for the warning, sir.

My name is Scott Peterson. I am the Executive Director of the Streamlined Sales Tax Governing Board. Prior to that, I was the Sales Tax Director for the state of South Dakota for 10 years. So I do have a lot of experience in how states administer their sales tax.

I'd like to talk to you today about three things. The work done by the Streamlined Sales Tax to make their sales tax simpler and more uniform, the impact of unpaid sales tax—you've heard that from Mr. Bercu—and the need for Congress to act.

Streamline was created by the National Governors' Association and the National Conference of State Legislatures in 1999 in response to the 1992 Quill decision, which the states felt that they lost, and years and years and years and years of debate and argument and court battles. The leaders of those two organizations at the time felt it was time for the states to sit down and have a legitimate conversation with businesses about the issue, and the issue was complexity.

We spent years trying to identify what the complexity issues were, coming up with best practices. Streamline is an organization designed to help states use best practices, modern business practices, in the way they administer their sales tax.

Our three goals—make things uniform that can't be made simple. Sometimes things can't be made simple. But if you can make them uniform, the retailers benefit from the fact that it's always the same way.

Balance the interest of state sovereignty with simplicity and uniformity. Don't ask a state legislator or a Governor to change their constitution for the sake of simplicity and uniformity. Find some way of doing these things that don't revolve around a political suicide or a practical impossibility.

Help the private sector make their software better. We strive to eliminate the administrative differences. We don't try to tell states you have to tax shoes if you don't tax shoes today; you have to tax digital goods if you don't tax digital goods today; you have to exempt groceries if you don't exempt groceries today.

Those are legitimate state policy issues that the consumers of those states and the legislators and the Governors of those states have an interest in having. Is there a legitimate reason for one state's sale tax return to be 16 lines different than its neighboring state's sales tax return when they tax exactly the same thing and have the exact same rate?

We created dozens of uniform definitions. One of the things retailers told us years ago was "You all tax and exempt almost ex-

actly the same thing, but you use definitions that differ from each other to a degree that makes it impossible for us to understand what you're trying to do."

Candy—half the states in this country exempt groceries, but they tax candy. And the state law would say "We hereby exempt groceries from the sales tax except candy." And it's the same word in every state's law, except when it comes time to administering the law, the Departments of Revenue and the retailers in those states came up with a different definition of what candy meant. So if you're a retailer looking at the state's law, and it says candy is taxable and groceries are exempt, you don't have a clue what candy means. We came up with a definition of candy.

Create uniform processes for sales tax returns, sales tax remittances. Try to get to one sales tax return around this country. Come up with one uniform exemption certificate. And, first and foremost, make sales tax administration software that exists in the private sector today better. We made it better in a couple of different ways.

One, we certify the accuracy. There are six companies in this country that sell the certified software. We've looked at their sales tax decisions. We have said to retailers, "If you use this software, it's going to give you the right answer every time."

Now, if on the off chance it's wrong one out of a million times, it's not your fault, Mr. Retailer. It's the state's fault, because the state didn't do a very good job of certifying the software. In addition, the Streamline states pay those six companies to provide this service to retailers when that retailer doesn't have an obligation to collect that state sales tax.

The impact of unpaid sales tax—I'm not going to tell you it's lost revenue, because that's not a very good selling point. I am going to tell you that it's unfair for one consumer to pay 100 percent of their sales tax and the next consumer not to pay 100 percent of their sales tax when they both make the exact same purchases. They just choose different venues in which to make the purchases.

And this isn't a bricks and mortar versus the Internet. This is a retailer versus retailer. Main street retailers who use the Internet are just as disadvantaged as Internet retailers in another state, just as disadvantaged as the bricks and mortars are.

And I've run out of my time, Mr. Chairman. Thank you.

[The prepared statement of Mr. Peterson follows:]

PREPARED STATEMENT OF SCOTT PETERSON, EXECUTIVE DIRECTOR, STREAMLINED SALES TAX GOVERNING BOARD

Thank you Chairman Rockefeller, Ranking Member Senator Hutchison and Members of the Commerce Committee for the invitation to talk to you today.

Introduction

I am the Executive Director of the Streamlined Sales Tax Governing Board. I want to talk with you today about three things: 1) sales tax simplification done by the 24 Streamline states, 2) the impact of unpaid sales and use taxes, and 3) the need for Congress to act authorizing willing states to require out-of-state vendors to collect sales and use taxes.

Background

Streamline was created in response to years of court battles ending in the 1992 Quill decision. The National Governor's Association and the National Conference of State Legislatures decided it was time to sit down with business to identify and

solve the sales tax administration issues business said made sales tax compliance complicated.

Streamline's Efforts

The three goals of Streamline are to: (1) make uniform those things that cannot be made simple, (2) balance the interest of state sovereignty with uniformity and simplicity, and (3) help the private sector make the best possible sales tax software and services available to retailers. We strive to eliminate the administrative differences between states while maintaining a state's sovereign authority to choose what and what not to tax.

The 24 Streamline states created and implemented uniform definitions for many commonly taxed and exempted products and services, such as groceries, candy, durable medical equipment, and digital goods. Streamline states created and implemented uniform procedures for electronic sales tax returns and payments and a single, central registration system retailers can use to register to do business across the country.

For a long time retailers have worked to automate every aspect of their business, including their sales tax obligations. Sales tax automation can be as simple as knowing what is the sales tax rate at any location or as complicated as knowing that a state has a 48 hour sales tax holiday on back-to-school supplies. The Streamline states enhanced the ability of retailers to automate sales tax collection by adopting uniform sales tax rules, such as defining what products are included in a back-to-school sales tax holiday, by evaluating and then certifying the accuracy of the tax answers provided by software companies, and by paying those companies to provide accurate answers and to file the tax returns and pay the tax. The Streamline certified software companies allow a retailer to automate and outsource their sales tax work. In addition each Streamline state pays the certified software companies to provide that service to retailers who do not have a physical presence in their state.

The impact of unpaid sales and use taxes

The impact of unpaid sales and use taxes isn't just a matter of some state not collecting what its tax law says should be collected. The sales tax is too often the price difference that turns local retailers into display cases for consumers who come in and try out the product and then go home and buy on-line. According to the Department of Commerce, e-commerce sales doubled from 2005 to 2011 and e-commerce sales in the first quarter of 2012 increased 15 percent more than the same quarter in 2011. E-commerce sales are increasing at a rate greater than total sales and the difference are sales that would have otherwise gone to a local retailer.

Should Congress authorize willing states to require out-of-state vendors to collect sales and use taxes

The 24 Streamline states believe Congress should exercise its authority over interstate commerce and authorize states to collect their sales tax. Opponents say the sales tax is too complex, that it will harm small business, that it is a tax increase, and that the states have not done enough.

Collecting is too complex

Every retailer today looks to automate everything that can be automated. Sales tax collection software exists, it works, and it is affordable. Internet shopping carts may be the perfect technological environment in which to collect sales taxes because the customer can't make a purchase without providing all the data necessary to determine what sales tax to collect. Technology exists today to easily collect sales tax.

It will hurt small business

Small main street businesses believe they are the small business that is being harmed as they try to compete against someone who isn't collecting the tax. Many of them believe they are at the mercy of a 6–10 percent government mandated price disadvantage. The Marketplace Fairness Act protects truly small businesses by exempting them from state authority. In addition, the Marketplace Fairness Act requires states to simplify their laws and processes, and requires them to provide software and services.

Collecting a tax that is already due is a NOT a tax increase

If the retailer doesn't collect the sales tax the consumer owes the use tax. Having the retailer collect the sales tax is the only efficient method. Collecting the use tax from consumers would require an army of auditors.

States have not simplified enough

One of the goals of Streamline is to balance state sovereignty with simplification. It would be easy to create a simple sales tax if we were starting over and if every retailer sold only one product and sold that product in only one way. Unfortunately, that isn't our reality. We have taken the knowledge of 70 years of sales tax collection and applied it to the millions of products being sold by millions of retailers and tried to achieve something that meets today's need

Conclusion

In conclusion, we believe that between the great advances in technology and the simplifications found in the Marketplace Fairness Act it is time for Congress to act. Many today believe the government is picking winners and losers in the retail community. It is time to treat all retail businesses the same. Congress has the ability to balance simplification with state sovereignty and equity. We encourage you to make that decision and act now.

The CHAIRMAN. Thank you very much, Mr. Peterson.

And now Steve DelBianco, who is Executive Director of the NetChoice Coalition. We welcome you.

STATEMENT OF STEVE DELBIANCO, EXECUTIVE DIRECTOR, NETCHOICE COALITION

Mr. DELBIANCO. Thank you, Chairman Rockefeller, Senator DeMint, members of the Committee. I also speak for the True Simplification of Taxation Coalition just formed, and that includes the American Catalog Mailers, the Direct Marketing Association, and the Electronic Retailing Association.

As the only one of seven witnesses you've heard today who doesn't support the legislation, I sort of feel like the body at an Irish wake. Everyone expects me to be here, but nobody really wants me to say anything.

But, after all, you've already heard how simple this is. Right? You've heard that constitutional restraint on state taxing powers is really a loophole and that it's unfair. You've heard that it's free and easy to pay taxes for 46 states and 9,600 jurisdictions. You've heard that the Internet is some foreign virus that's killing main street businesses around the country.

But not so fast, please. It's not nearly that simple. First, the founders put Article I in the Constitution because they knew the colonies favored their own businesses over out-of-state businesses by tariffs and trade barriers. The founders deliberately limited states' power to impede interstate commerce, and that was the basis of the 1992 Quill ruling. It wasn't to shield e-commerce, because it hadn't even been born yet.

SSTP, as Scott described, was the states' response to Quill, and for 10 years I've been to nearly all SSTP meetings and I'm a participant there. After a decade of trying, though, it's clear that states don't really want to give up the local rules and rates. They don't want to give up their own definitions. They don't want to give up thresholds, their own tax returns, and their own audits of every single seller.

SSTP is stalled out right now, but the big box stores desperately want to make Amazon collect in more states. So they've asked you to force remote collection on everyone without the true simplifications that I detailed in my testimony. This legislation lets states impose their tax disaster on businesses in your states, businesses

that have no votes and no voice and no benefits from the taxing state.

The second point is that I'm glad that Mr. Bercu claimed that it's free and easy to collect sales tax for other states, because as it turns out, the way he's doing it is perhaps free and it may be even easy, but it's completely wrong. I used the web store to buy a book this morning about the U.S. Constitution for delivery to my Virginia home. And in front of you is a panel showing the screen shot from today.

Like Mr. Bercu said, BookPeople did add sales tax, but not for me in Virginia where it's 5 percent. They added 8.25 percent, which is Austin, Texas' rate. They didn't have to look up the rate in Virginia. They didn't have to check to see if Virginia was having a sales tax holiday. They are later this month. They don't have to file returns in Virginia, and they don't have to face audits from Virginia.

So what BookPeople does today is not even remotely close to what this bill, 1832, would require. Selling books, if you think about it, is pretty simple. There's no size or color choices involved. But it's much harder for a business who does complex fulfillment. The Silver Gallery has a store on Main Street in Waynesboro, Virginia. They do $3 million in sales through multiple channels, online, web store, their Amazon store as well, and phone orders. And they do custom engraving on a lot of the jewelry that they ship.

So I've got a chart in front of you that shows the information systems that they built on their own to handle that custom engraving and ordering. They already collect for every single sale they make in Virginia, just like all online sellers do. They collect for their own states via their custom system. That's at the top of the chart.

But when discussing the challenges of collecting for 9,600 jurisdictions, a witness last week told the House Judiciary Committee, "That's easy. There's an app for that. You can just punch it in and it'll return the rate." But that app would have to be in the bottom row, Mr. Chairman, of the chart in front of you. Imagine every time something moves through my system, I have to punch in a rate and then punch it back into the system. That would never work for an automated shopping cart with a company with just four employees.

So is it free, the software? Yes, it's free like a puppy is free. They come with a lifetime of costs. And the Silver Gallery did a detailed estimate that it will cost them $22,000 to implement free software—at the bottom of the chart with all those blue arrows that connect it to their in-house information systems.

There are similar businesses in each of your states. I would be happy to talk to you about each of those examples, because they are real companies—Tamarack in Beckley, West Virginia, where 2,800 artisans reach customers around the country through their website. Those businesses in your states that use the Internet—they haven't made so much noise about this legislation so far. I think they're too busy just trying to survive the competition from Wal-Mart, Amazon, and the big box stores, who have huge economies of scale and enjoy local tax benefits.

But when your state's businesses have to start spending money on new systems and have to face 46 state audits, I think that's when you'll start to hear from them. And the thing is you won't be

able to help if you pass this legislation first. And don't expect the small seller exception to provide any relief, either. At $500,000 in retail gross sales, it won't even exempt a mom-and-pop operation in your states. And I look forward to talking to you about a more reasonable small business exception during the Q&A.

So, to close, I'd say that this shows that the Internet is not some deadly virus from outer space. We invented the Internet. The Internet is in every town of America, and it helps every business and every consumer find what they're looking for. So it doesn't make sense to think of the Internet as unfair or the enemy. So to paraphrase Pogo, that comic strip, we have met the Internet and it is all of us.

I look forward to your questions.

[The prepared statement of Mr. DelBianco follows:]

PREPARED STATEMENT OF STEVE DELBIANCO, EXECUTIVE DIRECTOR, NETCHOICE

Chairman Rockefeller, Ranking Member Hutchison, and members of the Committee: thank you for holding this hearing on whether new "internet tax" collection burdens would level the playing field for small business. My name is Steve DelBianco, and I serve as Executive Director of NetChoice, a coalition of leading e-commerce and online companies promoting the value, convenience, and choice of Internet business models. NetChoice members include industry leaders such as eBay, Expedia, Facebook, LivingSocial, NewsCorp, Overstock, VeriSign, and Yahoo, plus several thousand small businesses that go online to reach their customers.

NetChoice has been deeply engaged on Internet tax issues for over a decade, including debates in the Wall Street Journal, on CNBC, Marketplace radio, CNN, and PBS. Since 2004, we have participated in meetings of the Streamlined Sales Tax Project (SSTP), a long-term effort that S. 1832 seeks to sweep aside with an "Alternative" method to let states tax remote businesses.

NetChoice is a founding member of TruST, the coalition for True Simplification of Taxation, a new group whose association members also include: the American Catalog Mailers Association; the Direct Marketing Association; and the Electronic Retailing Association (*www.TrueSimplification.org*). Each coalition member has submitted written statements for today's hearing, and we respectfully ask that their statements be included as part of the hearing record.

In this testimony we are discussing legislation that would authorize states to impose sales tax obligations on out-of-state businesses. Our major points are:

1. For online and catalog businesses, S. 1832 would let 46 states impose new tax burdens that are uniquely complex and far more unfair than the current *Quill* standard of physical presence.
2. S. 1832 *does not require nearly enough sales tax simplification* to justify imposing these significant new burdens on out-of-state businesses.
3. The new tax burdens imposed by S. 1832 are *not justified by anticipated revenue,* since total potential sales tax on all e-retail is well below one percent of total state & local tax revenue.
4. S. 1832 *does not adequately protect America's small businesses,* where these new collection burdens would be disproportionately complex and expensive.

The Commerce committee has a unique perspective on the need to prevent state-imposed burdens on interstate commerce. To help with that deliberation, we begin with some straight answers to critical questions.

Why don't online retailers pay sales tax to every state?

Last November, the editors of the Wall Street Journal asked NetChoice whether all online retailers should have to pay sales tax to every state. My argument in the published debate began with this:

> Should online retailers have to collect sales tax? *Yes, and they already do.*
>
> Just like all retailers, online stores must collect sales tax for every state where they have a physical presence. That's why Amazon.com adds sales tax to orders from customers in the 5 states where it has facilities. But Amazon and online retailers aren't required to collect tax for other states, leaving those customers to pay a "use tax" that states rarely enforce against individual taxpayers. This

> framework frustrates state tax collectors and businesses that compete with online retailers. But when we learn how this physical presence requirement evolved, it becomes clear why we should retain this standard for imposing new tax collection burdens on online retailers.[1]

As members of this committee know, today's physical presence standard is based on Article 1 of the U.S. Constitution, designed 225 years ago to stop states from impeding interstate commerce. The Commerce Clause was a necessary condition to unite the independent colonies, since they had a legacy of imposing customs duties and trade barriers to favor in-state businesses.

Fast-forward to the 1960s, when state tax collectors wanted catalog retailers to collect their sales taxes, even where those catalogs had no operations in the state. The U.S. Supreme Court relied on the Commerce Clause in deciding that states could not impose tax collection requirements on catalogs "whose only connection with customers in the State is by common carrier or the United States mail."[2]

In 1992, the Supreme Court took another look at tax collection by an office products catalog company by the name of Quill.[3] Seeing a patchwork of rates and rules for several thousand sales tax jurisdictions, the Court again held that requiring out-of-state companies to collect and remit taxes was so complicated that it presented an unreasonable burden on interstate commerce.

Moreover, the Supreme Court was *not* moved by the state's argument that computer technology created the necessary simplification. Instead, the Supreme Court acknowledged the lower court's finding that advances in computer technology had eased the burdens of tax collection, but still found the requirement of tax collection unduly burdensome.[4]

Quill was not concerned with "fairness." While some argued fairness as justification for tax collection, "[i]n contrast, the Commerce Clause and its nexus requirement are informed not so much by concerns about fairness for the individual [state]

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[1] Steve DelBianco, *Should States Require Online Retailers To Collect Sales Tax?,* Wall Street Journal (Nov. 14, 2011) (emphasis added).

[2] *Nat'l Bellas Hess, Inc.* v. *Dept. of Rev. of Ill.,* 386 U.S. 753 at 758 (1967).

[3] *Quill Corp.* v. *North Dakota,* 504 U.S. 298 (1992).

[4] *See Quill Corp.* v. *North Dakota,* 504 U.S. 298 at 313 FN 6 (1992).

as by structural concerns about the effects of state regulation on the national economy."[5]

Quill is the law of the land today, protecting businesses from sales tax imposition by states where that business has no physical presence, while requiring businesses to pay sales tax for every state where they do have a physical presence.

Haven't states simplified their sales tax systems? What about the SSTP initiative?

Quill also made it clear that states could simplify their sales tax systems and come back to the Supreme Court at any time to argue that they had eliminated the unreasonable burden on interstate commerce. But instead, a handful of states chose to skip the harsh judgment of the Court and go directly to Congress to request the power to impose these burdens on out-of-state businesses—whether or not state sales taxes were significantly simplified.

State efforts began a decade ago with the Streamlined Sales Tax Project (SSTP). Despite a decade of concerted effort, the actual simplifications achieved by the SSTP are not nearly sufficient to justify Congress abandoning its role in protecting interstate commerce. Rather, the SSTP has shown that *simplification has become just a slogan—not a standard.*

First, critics cite the fact that SSTP originally promised just one tax rate per state, but now accommodates over 9,600 local jurisdictions,[6] each with its own tax rates and sales tax holidays. That's up from 7,800 jurisdictions in the 20 years since *Quill,* and still growing. This makes the U.S. a true outlier when it comes to sales tax jurisdictions. The European Union has 27 jurisdictions for Value Added Tax (VAT) and India lets each state have a single tax rate, but we are the only country where sales tax is controlled at the local government level.

Second, the SSTP has abandoned many of its original simplification requirements. For example, the SSTP no longer contains required compensation for all retailers and has all but eliminated the small seller exception. In an effort to attract states with origin sourcing, the SSTP abandoned one sourcing rule and now allows both origin and destination-based regimes—at the same time. To entice Massachusetts to join SSTP, the Governing Board voted to allow thresholds for certain clothing items, even though thresholds were one of the most complex elements it pledged to simplify. (Notwithstanding this allowance, Massachusetts has not yet joined SSTP.)

Despite these concessions to attract member states, less than half of eligible states have joined SSTP (only 22 full member states in SSTP, out of 46 states that have sales tax).

Why is SSTP losing momentum when states expect billions of dollars in new tax revenue?

Some argue that SSTP lost momentum because non-member states are reluctant to let unelected tax administrators make decisions about tax rules and determine compliance. More likely however, SSTP lost momentum because states began to see the revenue estimates as wildly inflated.

A simple calculation using government data shows that the maximum sales tax potential for consumer e-commerce *is less than one percent of total state and local tax revenue:*

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[5] *Id.* at 312 (emphasis added).

[6] "Vertex Press Release (Mar. 21, 2012), available at *http://www.vertexinc.com/pressroom/PDF/2012/vertex-address-cleansing.pdf* ("At the end of 2011, there were over 9,600 taxing jurisdictions across the U.S. with an average of 651 new and changed sales and use tax rates per year.").

Start with the U.S. Department of Commerce's *2010 Electronic Commerce Industry Assessment,* which reported total retail e-commerce of $169 billion.[7]

Apply an average tax rate of 7 percent, giving total potential sales tax of $11.8 billion.

Divide that by total state and local tax revenue in 2010, reported as $1.3 trillion by the Commerce Department.[8]

The result is clear: the maximum potential sales tax on all e-commerce is less than one percent of state & local tax revenue—*assuming that no sales taxes are collected by e-retailers.*

But under *Quill,* e-retailers already collect sales tax for states where they have physical presence, as seen in the table at right. NetChoice commissioned a study by economists Robert Litan and Jeffrey Eisenach to determine where e-retailers were already collecting sales tax for web sales.

Company	States
Amazon.com	5
Staples	44
Dell	46
Office Depot	46
Apple	46
OfficeMax	46
Sears	46
CDW	46
Newegg	3
Best Buy	46
QVC	46
SonyStyle.com	46
Walmart.com	46
Costco Wholesale	38
J.C. Penney	46
HP Office	46
Circuit City Stores	29
Victoria's Secret	45
Target	46
Systemax	5

They concluded that uncollected sales tax on e-commerce in 2010 was $4.2 billion nationwide, or *less than one-third of one percent of total state and local tax revenue.*[9] This relatively small incremental revenue does not justify a dramatic expansion of state taxing powers and new collection burdens on remote businesses.

Isn't there increased momentum to overturn Quill?

Recently, despite flagging momentum and diminishing revenue estimates, members of this committee have surely noticed increased lobbying efforts to overturn *Quill's* physical presence test and empower states to collect from remote retailers. Aside from the usual tax proponents in state government, the renewed push is coming from big-box retailers.

Big-box retail chains are pushing hard for Federal legislation for a simple and predictable reason: it serves *their* interests. Even a little simplification helps a big-box retailer who must already collect tax for most states, as seen in this list. Big-

[7] U.S. Census Bureau E-Stats, *http://www.census.gov/econ/estats/2010/2010reportfinal.pdf*
[8] U.S. Census Bureau E-Stats, *http://www2.census.gov/govs/qtax/2011/q2t1.pdf*
[9] Eisenach & Litan, *Uncollected Sales Taxes On Electronic Commerce: A Reality Check,* Empiris LLC (Feb. 2010), available at *http://bit.ly/EisenStudy.*

box retailers now have expansive web-stores of their own and give customers the convenience of doing pickups and returns at their local stores. These chains use plenty of local public services wherever they have stores, so they must collect sales tax in all their states—as required under *Quill.* The Eisenach study looked at sales collection practices for the top 500 e-retailers, and found that 17 of the top 20 already collect in at least 38 of the 46 sales tax states.

Another way that overturning *Quill* would also help big-box retailers is that it would force tax collection costs on their biggest online competitor, Amazon.

Why would Amazon.com support overturning Quill?

Big-box retailers have aggressively gone after Amazon in the states, lobbying for new "Amazon Tax" laws declaring that Amazon already has physical presence by virtue of its advertising affiliates, distribution centers, or other subsidiaries in the state. The big-box retailers also lobbied for a new tax reporting law in Colorado, which was enjoined by a Federal court as a violation of the Commerce Clause.[10] Despite the setback in Colorado and pending court challenges of the "Amazon Tax" in New York and Illinois, this aggressive and expensive state lobbying campaign has succeeded in creating well-publicized tax compliance problems for Amazon. Those problems have helped to drive Amazon to support Federal legislation to overturn *Quill.*

But there's another reason for Amazon's about-face: the company is changing its business model by adding distribution centers in new states to enable faster delivery to customers. Amazon is also adding drop-boxes in convenience stores and marketing daily deals to local merchants. As a result, Amazon will have physical presence in 14 states by 2014[11]—requiring Amazon to *collect sales tax for more than half of all Americans.* And as Amazon opens more distribution centers across the country they will continue to increase their tax collection requirements.

Like the big-box stores, Amazon would reduce its tax compliance costs if states adopted even tiny steps toward simplification. Moreover, Amazon and big-box chains benefit if Congress allows states to impose new tax collection burdens on their smaller online-only competitors.

To impose expensive collection burdens on small sellers would be grossly unfair, which brings us to the aspect of "fairness" in the debate over new Internet sales taxes.

Is this debate really about "fairness" for small business?

Yes, and "fairness" is what you get *when everyone plays by the same rules.* Today, with *Quill* in place, all online and offline businesses play by exactly the same rule: all retailers collect sales tax for every state where they choose to have a physical presence.

Ironically, in many states the fairness argument cuts the other way. A retail store on Main Street collects sales tax for just the one jurisdiction where it's located. But in most states, an online retailer operating right upstairs must collect and remit for each of the local towns and counties whenever it ships within the state. That means collecting for several hundred local tax jurisdictions, each with its own rates and rules. Yet when customers from surrounding towns walk in the door, the store collects and files only in the local jurisdiction.

Again, all retailers collect sales tax for every state where they choose to have a physical presence. I say, "choose" because it is the business that chooses whether to be just an online retailer or to operate physically in multiple states. When a business chooses to open stores or send sales reps to another state, it accepts the obligation to collect that state's sales tax, along with state-provided benefits of infrastructure, public safety, etc.

There's actually little evidence that retailers who do collect sales tax are losing significant sales to catalog and online retailers who collect sales tax only for their home state customers. That makes sense, since sales tax and shipping costs aren't added until a consumer's online shopping cart goes to checkout. So comparison shoppers are usually comparing prices *before* adding any tax and shipping charges. Moreover, online shoppers usually pay shipping and handling charges that offset any tax that's not collected on most commodities. Most shoppers go online for the convenience and selection available, not to avoid taxes. While small and expensive electronics are an anecdotal exception, tax proponents have shown no data indicating that significant

[10] *See* Order of Ct., *The Direct Marketing Ass'n v. Huber* (U.S. Dist. Ct. Colo. Mar. 30, 2012), *and see* 1 Colo. Code Regs. § 201–1:39–21–112.3.5 (2010).

[11] By 2014, Amazon will collect and remit sales taxes in the following 14 states: California, Indiana, Kansas, Kentucky, Nevada, North Dakota, New Jersey, New York, Pennsylvania, Tennessee, Texas, Virginia, Vermont, and Washington.

numbers of electronics shoppers deliberately choose out-of-state online retailers just so they can avoid paying sales tax.

For example, Amazon begins collecting sales tax in California on September 15, 2012 because it has physical presence there with its Kindle labs and new distribution centers. Even though customers in one of Amazon's largest markets is facing the prospect of an 8 percent effective price increase, the company is not warning analysts about any impending drop in sales. In a conference call with equity analysts on July 26, 2012, Amazon executives fielded questions about the sales impact of collecting sales tax in more and more states. The company's CFO said:

> "*We have also certainly added some new geographies or new jurisdictions that we clocked during that time period. But you see that we have seen very very strong growth even while collecting.*" [12]

This is more evidence that American consumers go online seeking better selection, convenience, and lower prices—they don't shop online to avoid paying sales taxes.

The argument that remote sellers have an unfair advantage just doesn't hold up. Paying sales tax for thousands of jurisdictions in 46 states is far more expensive and complex than paying sales tax for a single jurisdiction on over-the-counter purchases. Moreover, state and local governments often provide incentives and benefits to in-state retailers, such as tax increment financing, transportation improvements, worker training subsidies, grants, tax credits, property and income tax incentives, etc. None of these benefits are available to out-of-state businesses.

e-Commerce is the best hope for Main Street to compete with Big-Box Stores

Those who make the fairness claim about online versus offline are missing the far greater fairness concern of smaller retailers competing against big-box chain stores.

For decades, "Main Street" retailers have been getting battered by Walmart and other national chains. To survive, many Main Street retailers have gone online with their own web stores or with e-commerce platforms to serve repeat customers and to find new customers across the country. For example, the specialty retailer SilverGallery.com has a warehouse and store—located on Main Street—in Waynesboro, Virginia. SilverGallery, which was featured in a *Wall Street Journal* article last year, does some walk-in trade, but most sales come from their web store and other online channels.[13] Online sales growth enabled SilverGallery to buy their building and increase employment, right there on Main Street.

The last decade has seen another body blow delivered by big-box chains, who integrated their website operation with their stores in every city and town. Customers love the savings of doing in-store pickups to avoid shipping charges. And they love the convenience of returning online purchases to stores for exchange or credit—instead of packaging returns and standing in line at the post office. But small sellers like SilverGallery can't afford to open stores in every state. It's yet another advantage that big retailers have over small businesses with websites. The big chains also negotiate much lower rates for advertising, shipping costs, and health insurance, too.

Next comes the knockout punch for small retailers. Overturning *Quill* may be good news for big-box retailers with websites, since they already have to collect in nearly all states. But overturning *Quill* will definitely raise costs and prices for small businesses that compete—and survive—via their web and catalog sales.

There's collateral damage of overturning *Quill* when it comes to artisans and specialty manufacturers in your state. Smaller suppliers have little hope of qualifying to be on the shelves at Walmart or Target. For artisans and small manufacturers, distribution comes through their own Internet web stores and specialty catalogs, which are in no position to absorb the extra costs of collecting for not just one state, but 45 additional states. Those costs are described in the next section.

What is the impact on small businesses if they are required to pay sales tax to 46 states?

What costs would a small business face if Congress forced them to pay sales tax to all 46 states? The SST's own Cost of Collection[14] study found that a small business (under $1M in annual sales) spends 17 cents for every tax dollar it collects for states. And even if tax software works as promised, that only helps with 2 cents

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[12] Tom Szkutak, CFO, in a transcript of Amazon's Q2 2012 Earnings Call, *http://seekingalpha.com/article/754571-amazon-com-s-management-discusses-q2-2012-results-earnings-call-transcript?part=single*

[13] *See* Angus Liten, *Sales-Tax Measures 'to Cost Us Big'*, Wall. St. Jo. (Dec. 1, 2011).

[14] Available at *http://www.netchoice.org/wp-content/uploads/cost-of-collection-study-sstp.pdf*.

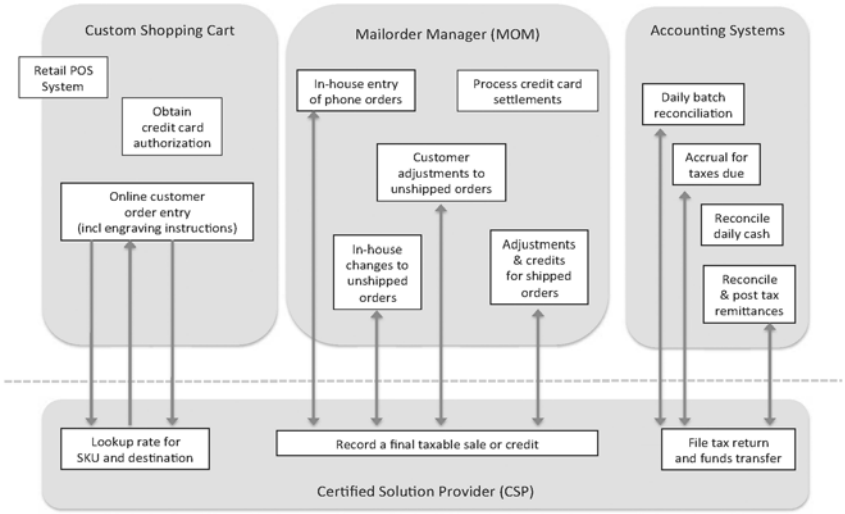
of the 17 cents in costs per dollar collected. *That leaves small businesses with a 15 percent cost burden on every dollar they collect,* for things such as:

- Paying computer consultants to integrate new tax software into their home-grown or customized systems for point-of-sale, web shopping cart, fulfillment, and accounting
- Training customer support and back-office staff
- Answering customer questions about taxability of items, or sales tax holidays
- Handling audit questions from 46 states
- Paying accountants and computer consultants to answer all these questions

These collection burdens will be a big problem for small catalog and online businesses that collect only their home-state sales tax today. Ask any small business, on Main Street or online, and you'll learn it's hard enough to collect sales tax for one state, let alone all 46 states with sales tax laws of their own.

One of the most significant costs and challenges for remote retailers is integrating tax rate lookup software into their in-house information systems. This point was demonstrated when the Silver Gallery explained to the Streamlined Sales Tax Governing Board how they would incur nearly $22,000 in costs for design, programming, integration, testing, and employee training. This cost estimate was developed for the task of integrating "free" software into Silver Gallery's existing information systems, at each of the integration points shown in their diagram below.

Integration challenges for Silver Gallery in using a Certified Solution Provider (CSP)



With that understanding of what small online businesses would face from overturning *Quill,* it's easy to see why Senate Commerce Committee members Ayotte, Begich, and Heller co-sponsored a resolution to protect our Nation's Internet entrepreneurs from new tax collection burdens. S. Res. 309 is titled "Supporting the Preservation of Internet Entrepreneurs and Small Businesses," and its main point is this simple pledge:

> Congress should not enact any legislation that would grant State governments the authority to impose *any new burdensome or unfair tax collecting requirements on small online businesses and entrepreneurs,* which would ultimately hurt the economy of, and consumers in, the United States.[15]

The bottom line on "fairness" is that big-box retailers have wielded that term for their own benefit, to the detriment of any small retailers they haven't already extinguished.

[15] S. Res. 309, 112th Cong. (2011) (emphasis added).

Would S. 1832 create a new tax burden on businesses?

State sales tax laws put obligations on both buyers and sellers in order to maximize tax revenue collection. States levy a sales tax on sellers within their jurisdiction, and it's usually up to the seller whether to pass the tax along to buyers, whether at the cash register, online, or over the phone. But after an audit, a seller is liable for any sales tax they were obliged to collect but failed to collect, even when the seller can't recover the tax from those previous customers.

Moreover, several states impose their sales tax for the "privilege" of selling goods to state residents, even if shipped via common carriers:

> *Arizona:* "The Arizona transaction privilege tax is commonly referred to as a sales tax; however, the tax is on the privilege of doing business in Arizona and is not a true sales tax. Although the transaction privilege tax is usually passed on to the consumer, it is actually a tax on the vendor."[16]
>
> *California:* "The sales tax portion of any sales and use tax ordinance adopted under this part shall be imposed for the privilege of selling tangible personal property at retail"[17]
>
> *Michigan:* "there shall be collected from all persons engaged in the business of making sales at retail, by which ownership of tangible personal property is transferred for consideration, an annual tax for the privilege of engaging in that business equal to 6 percent of the gross proceeds of the business, plus the penalty and interest if applicable. . ."[18]

Today, only businesses that have presence in these states are required to pay a tax for the privilege of engaging in business there. S. 1832 would enable states to impose their "privilege" tax on businesses with no facilities, no vote, and no voice in those states. Sales and "privilege" taxes are the personal liability of the seller. The fact that the tax can be passed on to consumers does not make it any less a *new tax burden* for businesses all over the country.

Clearly, sales tax is due from *sellers* whose activities or locations create enough of a physical presence for a state to impose collection obligations. But if Congress overturns the *Quill* standard, businesses would be forced to pay a new tax to states where they have no physical presence. Most of those businesses would pass the tax along to their customers, but make no mistake about it—the states will demand that businesses pay the new tax—whether or not their customers were charged.

If Congress were to enact S. 1832, your state businesses will hear about these new tax obligations for the first time when they receive demand letters and audit notices from dozens of states. That may be the first time you hear from many businesses in your own state, when they complain about complex new burdens of collecting taxes for 45 additional states.

S. 1832 is not an improvement on Quill's physical presence standard.

The actual simplification required in S. 1832 is not nearly sufficient to convince Congress that it should abandon its Constitutional role in protecting interstate commerce.

Fortunately, Congress can afford to take the time to design legislation that requires real simplification and makes states accountable to these requirements. As noted above, the uncollected taxes are far lower than tax advocates have claimed: uncollected sales tax on consumer e-commerce is under one percent of all state and local taxes. And the uncollected amounts are not growing as fast as tax advocates have claimed, since the fastest growth in e-commerce is among multi-channel retailers who already collect for states where they have stores—17 of the top 20 e-retailers collect for at least 38 of the 46 sales tax states.[19] And Amazon.com will collect for over half the U.S. population by 2014—under the *Quill* standard of physical presence.

However, if Congress is determined to overturn Constitutional protections for interstate commerce, it must exempt small businesses, require states to adopt minimum simplification requirements, and create fair procedures to resolve sales tax disputes between states and taxpayers. Each of these points is covered below.

S. 1832 does not include adequate protection for small businesses

S. 1832 includes a small seller exception that is appropriately mandated by Congress, as opposed to other legislation that leaves it to state tax administrators to

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[16] *http://www.azdor.gov/business/transactionprivilegetax.aspx*

[17] *http://www.boe.ca.gov/lawguides/business/current/btlg/vol1/ulsutl/7202.html*

[18] Michigan Compiled Laws Of 1979, Chapter 205 Taxation, General Sales Tax Act, § 205.52]

[19] Eisenach & Litan, *Uncollected Sales Taxes On Electronic Commerce: A Reality Check,* Empiris LLC (Feb. 2010), available at *http://bit.ly/EisenStudy.*

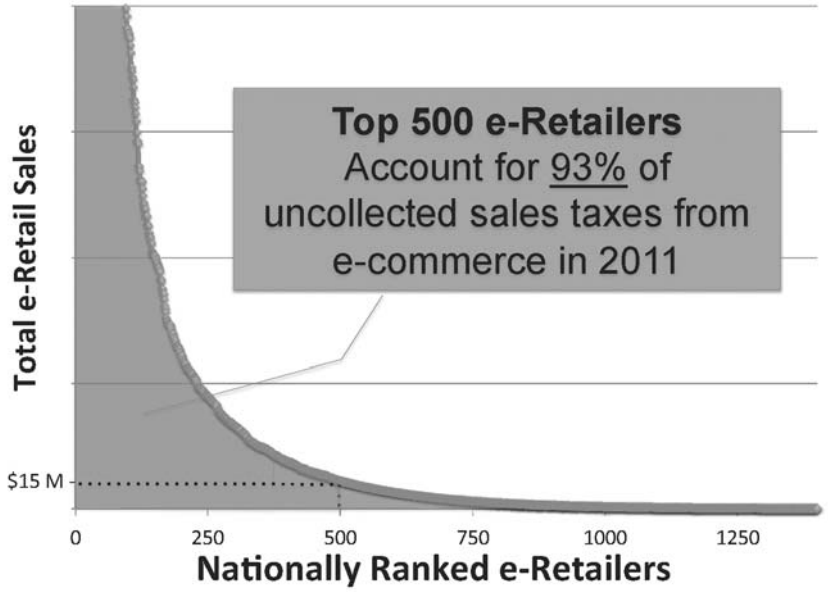
set the exception level. But S. 1832 sets the exception threshold at just $500,000 in annual remote sales, a number that is far too low for retailers, whose entire expense and payroll must be paid from the margin on sales:

- $500,000 in gross sales times 25 percent average gross margin leaves just $125,000 to cover all other costs of running the entire business.
- All other costs would include advertising, rent, supplies, insurance, shipping, computers and programming, website, accounting, communications, travel, etc.
- If there's anything left after paying those costs, this business *might* be able to pay the owner a modest salary. But there's nothing left to pay other employees.

Make no mistake about it—$500,000 in retail sales is still just a sole proprietor operation. The Small Business Administration says a "small" retailer is one with annual sales 40 to 60 times larger than the threshold in S. 1832.

One way to set a more realistic small seller exception is to exempt all businesses that are out on the "long tail" in terms of e-retail sales. For example, *Internet Retailer* publishes a *Top 500 Guide* each year, ranking the Nation's largest retailers on their U.S. e-commerce sales. For 2011, the #1 e-retailer was Amazon.com, at $48 billion in e-retail sales. Number 500 had just $15 million in remote e-retail sales. In total, the Top 500 had $181 billion in e-retail sales.

Economists Eisenach and Litan started with this Top 500 Guide when analyzing where each retailer already collected sales tax under *Quill*'s physical presence standard. Using their analysis, we estimated that the Top 500 were responsible for 93 percent of the uncollected sales tax on U.S. e-commerce in 2011, as shown in the graph below[20] (*netchoice.org/top500collect*).



Congress could set a small seller exception that adjusts with inflation and retail trends by exempting sellers below the *Top 500* cutoff from the previous year. Under this method, *the small seller exception for 2012 would have been $15 million in annual sales.* That would leave exempted retailers with a more reasonable gross margin to cover expenses, *while allowing states to recover over 90 percent of the uncollected sales tax on e-retail.*

[20] Top 500 e-Retailers and total e-commerce sales from Internet Retailer, Top 500 Guide, p. 32 (2012 Edition). Top 500 e-retailer tax collection from Eisenach & Litan, Uncollected Sales Taxes On Electronic Commerce: A Reality Check, p.17, 25 (Feb. 2010), available at *http://bit.ly/EisenStudy*

S. 1832 fails to require true tax simplification or reduce administrative burdens

Congress should require robust minimum simplifications before overturning the *Quill* standard of physical presence for states to impose sales tax on remote businesses. Previous Congressional legislation to overturn *Quill* included as many as *16* minimum simplification requirements that SSTP states would have to honor. But S. 1832 requires only *3* measures and they lack essential provisions:

Minimum Simplification Requirements lacking in S. 1832:

- Remote retailers should not be subject to audits from 46 separate state tax authorities. States should respect the outcome of a single audit by any state, on behalf of *all* states.
- Remote retailers should be allowed to use a single sales tax rate for remote sales made into each state, which was the original goal of the SSTP. State lawmakers would, of course, be able to allocate sales tax proceeds among local jurisdictions.
- States should be required to adopt a single set of definitions for taxable and exempt products across *all* states. S. 1832 allows each state to have its own unique definitions:

  "(g) Provide a uniform sales and use tax base among the State and local taxing jurisdictions within the State."

- States should compensate all businesses for the fair and reasonable cost of collecting sales taxes, taking into account such elements as credit card fees and costs of software implementation and maintenance. Compensation was required in previous Federal legislation to overturn the *Quill* physical presence standard, but was dropped in recent versions. S. 1832 requires no compensation for either the integration costs or collection costs incurred by businesses in order to collect state taxes.
- Remote businesses should not be required to file sales tax returns for all 46 states. All states should accept a single sales tax return filed with a business' home state. The home state revenue department would be responsible for distributing funds to remote states.
- Remote retailers should not be *required* to honor, but may observe, thresholds for sales tax calculation. (an example of a threshold is Massachusetts, where the first $175 of any clothing item is exempt from sales tax.[21])
- Remote retailers should not be *required* to honor state-specific sales tax holidays.
- States should be required to adopt a single rule for sourcing sales. The SSTP originally maintained destination sourcing for all sales tax transactions. But to accommodate origin-based states, SSTP's Governing Board voted to allow origin sourcing for in-state sales while requiring destination sourcing for remote sales. Such "dual sourcing" should not be permitted as part of any Federal legislation overturning the physical presence standard.
- States must provide certified software for collection, filing, and remittance of taxes. But S. 1832 requires only that states provide software "that identifies the applicable destination rate". That leaves remote businesses to bear the full cost of integrating the rate lookup into their in-house systems and processes. And the business would also have to pay for software to handle filing and remittance in 46 different states.

These minimum simplifications should be required for any state that seeks collection authority outside of *Quill's* physical presence standard.

And if Congress were to grant states taxing powers over out-of-state businesses, it should explicitly prohibit states from otherwise attempting to stretch the definition of physical presence, such as many states have attempted through laws asserting that advertising alone creates nexus.

S. 1832 fails to hold states accountable to simplification requirements

If Congress grants states the authority to impose sales tax on remote sellers, there must be a mechanism to hold states accountable to the minimum simplification requirements above. S. 1832 does not designate Federal court jurisdiction, so disputes would be subject to the Tax Injunction Act (28 U.S.C. § 1341), where tax-

[21] *http://www.mass.gov/dor/individuals/taxpayer-help-and-resources/tax-guides/salesuse-tax-guide.html#apparel*

payers are forced to use *state* courts to litigate disputes with state tax collection authorities—even on questions of whether a state is following Federal law. It would be far better if Federal courts had sole jurisdiction over disputes arising between states and remote businesses regarding a state's compliance with Federal law.

Congress should consider a multi-state compact to preserve tax competition among the states

Congress should retain the benefits of market discipline to restrain states from expanding the complexity of their sales tax systems and skirting the minimum simplification requirements. Fortunately, Congress has a simple way to enforce "tax competition" as part of any legislation that overturns the physical presence standard: *Congress could authorize remote collections through a multi-state compact instead of a national mandate on all* ***businesses.***

S. 1832 would impose collection burdens on businesses in *all 50 states*—including those in states that don't even have a sales tax. Lawmakers in all 50 states would lose the sovereign right to protect their citizens and businesses from tax burdens imposed by other states.

If these new collection burdens are hurting businesses in a state, their legislators won't be able to rescue those businesses if Congress makes collection mandatory for all. This comes as a surprise to many lawmakers who are just beginning to understand the implications of legislation such as S. 1832.

Contrast the national mandate in S. 1832 with a multi-state compact, where states could opt-in if they believed new tax revenues justified having their in-state business collect taxes for other states in the compact. By the same token, states could *opt-out* of the compact if remote state tax burdens were excessive. States opting-out would lose the power to force remote sellers to pay their sales tax, but at least states could protect their own businesses from unreasonable burdens on interstate commerce.

Conclusion

Quill's physical presence standard remains a principled and practical way to limit states' imposition of tax burdens on out-of-state businesses. Congress should not sweep *Quill* aside without first requiring that states truly simplify their tax systems in an accountable way, while providing adequately protection for America's small businesses.

The CHAIRMAN. Thank you very much.

On our side, I'd like to yield my right to ask first questions to Senator Durbin, who is an author of this bill and has taken the time out of his busy schedule to be here. And after that, when the next Democrat comes up, it will be Senator Nelson.

On the Republican side, that would be up to you, Mr. Ranking Member, and also Assistant Ranking Member Ayotte, if you would have Senator Alexander go ahead and ask the first question.

All right. Senator Durbin.

Senator DURBIN. Thank you, Mr. Chairman. It's very kind of you.

Mr. DelBianco, first, it's the state's option. The state has to decide whether they want to be part of this. It is not mandated on any state. Second, the notion that every retailer then has to go fix the sales tax software—that is not the purpose. In fact, just the opposite is true. We're trying to establish a national access to software for every retailer, simplify it, make it direct, and put the burden on someone other than the small business to make sure that it's timely.

Third, Mr. Misener, you represent the largest Internet retailer in America today. In the recent past, Amazon has opposed measures taken by the states and others when it comes to sales tax collection. Mr. DelBianco is still trying to protect you, but you've come here to endorse this bill. So can you tell us why Amazon, the largest Internet retailer, would support a bill which Mr. DelBianco thinks is so deleterious to Internet commerce?

Mr. MISENER. Senator, we always have—I joined the company over 12 years ago, and one of the first choices we had to make as a policy decision was whether or not we were going to oppose sales tax collection or support it. At the time, as you may recall, the Internet Tax Freedom Moratorium was up for renewal, and there was talk about the Internet should be free of all taxes, including sales taxes.

We had a choice. Do we simply ride the coattails of the Internet Tax Freedom Act and oppose all sales taxes as well, or do we work with the states? We chose the latter. When we work with the states, we work cooperatively. Mr. DelBianco mentioned that he's also worked in Streamline. I think he worked in Streamline much like Napoleon visited Moscow. It was really—sorry.

But we tried to be cooperative, and I think the Streamlined Sales Tax Project representatives would grant that. When we were going through the past decade of work in Streamline, it became clear that the large states weren't going to join. And so the innovation in your bill now is allowing the large states also to participate in this in a way that makes it feasible nationwide.

And so that's why we're so supportive of this legislation. We always have been, but now, in particular, your legislation takes care of a preexisting problem, which was that Streamline was the only way to go. Now, you've produced alternatives for the states.

Senator DURBIN. Mr. DelBianco also suggests that keeping up with 9,600 taxing jurisdictions is beyond the grasp of many Internet retailers. Well, you're the largest, and you would be affected more than anyone. So how do you deal with the fact that laws do change?

Mr. MISENER. Well, we try to keep up, for sure. And we offer our sellers a service by which we will collect the sales tax for them. Mr. DelBianco's point on fairness, I think, is that it's harder for smaller businesses to do this. If smaller businesses were to do what we've done, which is to build a homegrown system, that would be enormously difficult for them.

But they don't have to do that anymore. That was the case six, 7 years ago. But now there are a host of service providers who can do this for them without them having to reinvent the wheel.

Senator DURBIN. So, Mr. Bercu, let's go to the purchase that he made today—Mr. DelBianco made today—at your store and believes he should have been charged the Virginia sales tax and he was charged the Austin, Texas.

Mr. BERCU. Well, evidently, there's a mistake in the sales tax, assuming this is exactly what happened. But the bill, as I understand it, specifically protects small retailers by choosing certified data providers and certified back ends for our websites that would cover all of this. If there was a mistake made, obviously, as a retailer, I would certainly refund the extra money. But that's not particularly a big issue. I actually did not know about this, and I will certainly check with our provider to find out what happened. I don't know.

Senator DURBIN. So the bill would actually simplify it?

Mr. BERCU. The bill would make it much simpler, as I understand it. It would, number one, protect me as long as I'm using the certified data providers, as I said. And, also, it would give me a

place to go look for those certified data providers without even having to look for myself.

Senator DURBIN. Thank you.

Thank you, Mr. Chairman. I appreciate your kindness in allowing me to ask questions.

The CHAIRMAN. Thank you, Senator Durbin.

Senator Alexander.

Senator ALEXANDER. Mr. Chairman, I've pretty well had my say, and I thank you for that. There are a lot of Republican members here. Let me just ask one question of Mr. Peterson, who has been involved a while. It's about the *Quill* decision that Senator Ayotte certainly properly asked about.

The way I read the *Quill* decision, it says the following. The Supreme Court decision said 20 years ago it was too complicated to allow states to require out-of-state sellers to do the same thing in-state sellers do. But the Supreme Court said, quote, "This aspect of our decision is made easier by the fact that the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve. No matter how we evaluate the burdens that use taxes impose on interstate commerce, Congress remains free to disagree with our conclusions." That's the Supreme Court.

Accordingly, 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. What's different today?

Mr. PETERSON. Thank you, Senator Alexander. There is a lot that's different today, because, actually, in 1992, the Supreme Court based that decision on the 1967 decision they had made, and it was effectively a stare decisis decision where they said, "We're not going to overturn the decision we made in 1967," because there had been an industry that had developed around that decision.

But the difference in 1992 was they said, "This is interstate commerce." They eliminated the due process issue that they had raised in 1967. They said that this is just an interstate commerce issue, and Congress has the authority to regulate interstate commerce. And if Congress wanted to act, they would be able to do so, and they would be able to set the rules in which states became engaged in regulating interstate commerce.

Senator ALEXANDER. Thank you, Mr. Chairman.

STATEMENT OF HON. KAY BAILEY HUTCHISON, U.S. SENATOR FROM TEXAS

Senator HUTCHISON [presiding]. The Chairman has stepped out. Let me say that I apologize for being so late, and I especially welcome Mr. Bercu from Texas. I'm just going to give my opening statement in the record so that you don't have to listen to it.

[The prepared statement of Senator Hutchison follows:]

PREPARED STATEMENT OF HON. KAY BAILEY HUTCHISON, U.S. SENATOR FROM TEXAS

Thank you, Chairman Rockefeller, for holding this hearing, and I appreciate all of the witnesses for being here today to provide testimony.

I would especially like to thank Mr. Bercu from BookPeople in Austin, Texas, for traveling here to testify before us today.

In my state of Texas, which does not have an income tax, we rely heavily on revenue collected by sales taxes.

This is why during my tenure in the Senate I have worked so hard to ensure the permanent deduction of state and local sales taxes. Without this deduction, taxpayers in Texas would see their Federal tax bills increase by an average of $500 for 2012.

However, the issue that we are discussing today—uncollected sales taxes resulting from online purchases—is of concern to many brick-and-mortar businesses and needs to be explored.

Bipartisan legislation introduced by my colleagues, Senators Enzi, Alexander, and Durbin, takes a first step in trying to address this issue.

The Marketplace Fairness Act provides states two options if they choose to collect sales taxes from remote sellers: they can either join the Streamlined Sales Tax and Use Tax Agreement or they can adopt six minimum requirements to streamline their taxes.

My home state of Texas has not joined the Agreement, and under the Marketplace Fairness Act, Texas would not be required to do anything.

Instead, if Texas wanted to collect taxes from remote sellers, it would have the choice of whether and how to pass the minimum requirements set forth in the bill.

I strongly support states' rights, and I think they should have the power to decide for themselves if it is in their constituents' best interests to change their respective state laws to collect sales taxes from remote sellers.

I hope the focus of today's hearing will be on how the Marketplace Fairness Act might affect states' ability to collect sales tax and the impact—if any—the law might have on small businesses.

Additionally, I would like to hear from the witnesses today about the cost implications that may be placed on states or businesses implementing the minimum streamlining requirements in this bill.

I also look forward to hearing the perspective of Mr. Bercu, whose business, which has an online presence in addition to his brick-and-mortar store in Austin, is currently collecting sales taxes from remote sales.

I believe the discussion today will provide an opportunity to explore these issues and whether further dialogue and steps are necessary to ensure that states' rights are not constrained by this legislation.

Thank you.

Senator HUTCHISON. I was working on the cybersecurity bill and just couldn't get away on time. We are working feverishly to get an agreement to move forward on cybersecurity. So I do apologize.

But let me go ahead and call on the next person who was here, which would be Senator Ayotte. But let me ask after Senator Ayotte—Senator Klobuchar has to preside at 4, so I do want to allow her to get some questions in. So I'll go ahead with Senator Ayotte, and then go to Senator Klobuchar.

Senator AYOTTE. Thank you.

Mr. Misener, can you tell me how many accountants work for Amazon?

Mr. MISENER. Accountants—I presume you're meaning with respect to tax.

Senator AYOTTE. Well, just roughly.

Mr. MISENER. So, globally, somewhere between 30 and 40.

Senator AYOTTE. And how many work in your IT department?

Mr. MISENER. Oh, gosh. Remember, we're an IT company, so we've got thousands of——

Senator AYOTTE. A lot? Thousands?

Mr. MISENER. Yes, ma'am.

Senator AYOTTE. And, you know, how many actually probably work for you that—we talked about accounting. You probably have a pretty big even government affairs department.

Mr. MISENER. Sadly, no.

Senator AYOTTE. No?

[Laughter.]

Senator AYOTTE. Well, there's probably plenty that would love to step up there. But here's the difference. Do you think that my company from New Hampshire, NobleSpirit, the company I mentioned, has a team of IT professionals and accountants? Because if this goes forward, many companies in a state like mine of New Hampshire and many businesses across this country are now going to have to not only comply with—to find a way for the software that you all described that's so easy to administer—we've already seen some of the difficulties—but also then they are subject to filing tax returns in every single one of those jurisdictions. Isn't that right?

Mr. MISENER. Not necessarily, Senator. What I would point out to you is that NobleSpirit is an eBay power seller, which entitles them to eBay tax remittance services provided by——

Senator AYOTTE. OK. Well, let's take another small business that's not connected there. They don't have to file taxes in those states? They're not going to have to file tax returns? Did I miss something?

Mr. MISENER. They need to file, but they don't need to do it themselves. The service providers are enabled and doing it already for tens of thousands of sellers.

Senator AYOTTE. And that doesn't cost them something?

Mr. MISENER. Oh, sure, it costs them something.

Senator AYOTTE. Sure. And——

Mr. MISENER. Not 30 or 40 accountants globally, not compared to Amazon. They pay a lot less.

Senator AYOTTE. But let's just agree with me that your small business doesn't have the team of IT or accountants. Correct?

Mr. MISENER. They don't need it for this purpose.

Senator AYOTTE. But they also are going to have to file tax returns that they never had to file before in every jurisdiction that they sell something to if they fall outside the exemption. Correct?

Mr. MISENER. They don't. They need to have it done on behalf of them.

Senator AYOTTE. On their behalf. They've got to pay someone to do it in some way. Correct?

Mr. MISENER. Yes.

Senator AYOTTE. And, in addition, if they are then audited in any of those jurisdictions, they have to then go and defend themselves against an audit in other states. Correct?

Mr. MISENER. That's correct.

Senator AYOTTE. And that costs—lawyers. You might have a few lawyers that work for you as well.

Mr. MISENER. Not any good ones.

[Laughter.]

Senator AYOTTE. OK. Well, let's face it. That's very costly for small businesses as well. So this is not really comparable to compare Amazon in terms of how you could treat those costs versus the burden on a small business.

And I would like to ask Mr. DelBianco to comment on that. And, if you could, comment also on the fact that the small business exemption is so small compared to other exemptions, even those set by our Small Business Administration.

Mr. DELBIANCO. Thank you, Senator. You asked about NobleSpirit. And think about it. NobleSpirit, more than likely, has

a cash register for walk-up sales. They have their own website. They may have a catalog. I don't know if they take phone orders. And they may sell on places like eBay and Amazon, just like Silver Gallery that I described earlier on the chart that you have in front of you.

When that happens, they have multiple information systems that handle the sale. It isn't just one place. So each and every step of their fulfillment, from the cash register in the front to the back office, all have to be tied into this free software, and there's where the tremendous expense is incurred.

You asked about the small seller exception. Just think about this for a moment. The $500,000 small seller exception—think about it—$500,000 times 75 percent cost of sales at a 25 percent gross margin means they're spending $375,000 for the cost of goods, then thousands more for marketing, advertising, traveling to trade shows, more for computers, programming and accountants, supplies and insurance, shipping, and a website.

When you do that, you're lucky in a good year if there is anything left at all to pay the owner. A $500,000 retail seller is no more than a sole proprietor. This small seller exception needs to be much higher.

Senator AYOTTE. Mr. Peterson, states have to opt in to the Streamlined Sales Tax Governing Board. Is that right?

Mr. PETERSON. Yes, ma'am.

Senator AYOTTE. And why shouldn't states like mine that don't have a sales tax be able to opt out?

Mr. PETERSON. There's a misunderstanding of what it means to opt-in and opt-out. You opt-in to Streamline because you agree to change your laws so they look like your neighbor's laws. New Hampshire wouldn't have any laws to change. You're comparing New Hampshire retailers with South Dakota, the state. South Dakota, the state, decided to join Streamline because they wanted their sales tax administrative practices to look like North Dakota's and to look like Tennessee's.

The state of South Dakota doesn't have any authority over the retailers in South Dakota. They can't tell a retailer in South Dakota, "You have to collect somewhere else." So there's a difference between the two concepts.

Senator AYOTTE. But one concern I have about this whole thing is that in a state like mine, like New Hampshire, where we don't have a sales tax, essentially, what you're going to have is a whole host of my businesses are going to now have to not only file all of the paperwork we talked about, to be the essential tax collector for other businesses, but then we're now in a position where states who have actually chosen, like mine, to not have a sales tax—I think they should have the option of opting out of these collection requirements to be fair to those states.

The CHAIRMAN [presiding]. Senator Ayotte, I don't mean to be rude, but you're over your time, and a lot of people have to ask questions. Will you excuse me?

Senator AYOTTE. Yes. I'm sorry.

The CHAIRMAN. Thank you.

Senator Klobuchar.

STATEMENT OF HON. AMY KLOBUCHAR, U.S. SENATOR FROM MINNESOTA

Senator KLOBUCHAR. Thank you very much, Mr. Chairman. Thank you to our witnesses. Today we're here to discuss the Marketplace Fairness Act, and while I know that there are people that like to complicate this issue—and I understand that there are concerns from certain states—I really see it as something quite simple.

We are here because of *Quill* v. *North Dakota,* my neighboring state of North Dakota. In that 1992 case, the Supreme Court made clear their decision need not be the final word. And they wrote, "our decision is made easier by the fact that the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve." And that's what we need to do.

I thought Senator Alexander's testimony, when he talked about how it's really two words—this is about states' rights and the states' abilities to do their work. And we have the fact that this isn't a new tax. This is simply about collecting taxes. And I note that several Governors were noted as supporting this bill, including Governor McDonnell of Virginia and Governor Christie of New Jersey. I would also like to add Governor Dayton of Minnesota.

And, Mr. Chairman, I would like to put this letter in the record.

The CHAIRMAN. So ordered.

[The letter follows:]

STATE OF MINNESOTA
Saint Paul, MN, July 31, 2012

Hon. AMY KLOBUCHAR,
Senator,
United States Senate,
Washington, DC.

Dear Senator Klobuchar:

Thank you for your co-sponsorship of the bipartisan "Marketplace Fairness Act" (S. 1832). I am pleased to learn the Senate Commerce Committee will hold a hearing on "Marketplace Fairness" and strongly support your leadership to move this measure forward.

Today, e-commerce constitutes a large and growing share of retail sales in the U.S. as well as an expanding tax enforcement problem, which states can ill afford during a period when their resources are already spread thin. More specifically:

- E-commerce sales comprised 5.6 percent of all U.S. retail sales in the fourth quarter of 2012.
- During the 2011 Holiday Season, U.S. consumers purchased 16 percent more over the Internet than during the 2010 season.
- Minnesota lost about $394 million last year from e-commerce and remote sales upon which tax is legally due but not collected. This lost revenue comprised over 7 percent of Minnesota's general sales tax liability in 2011. Not collecting those obligations translates into an increased burden on other taxpayers and reduced funding for public services and infrastructure.
- The inability to collect the legally due tax on e-commerce provides a significant and unfair tax advantage for on-line retailers to the detriment of Minnesota's Main Street businesses. In Minnesota, local brick-and-mortar retailers assess sales tax at a rate of 6.875 percent (the state sales tax rate, excluding local rates), while their on-line competitors typically assess no sales tax.
- Customers buying the same item are taxed in different ways depending on where the purchase is made. This encourages tax avoidance and undermines revenue stability and tax fairness.

Under the U.S. Supreme Court's 1992 *Quill Corp.* v. *North Dakota* decision, only retailers who have physical presence in a state can be required to collect and remit sales tax from consumers. While a use tax is technically imposed and owed by the

consumer, very few comply with or are even aware of their tax obligation. It is important to note that e-commerce as we know it today did not exist in 1992.

In Quill, the court explicitly held that Congress can resolve this unfairness once sales tax simplification occurs and there is no burden to interstate commerce under the Commerce Clause. This presents an important opportunity for Congress to resolve this inequity, as you well know.

As you also know, Minnesota has already simplified its sales tax system through participation as a full member of the multi-state Streamline Sales and Use Tax Agreement (SSUTA). The 24 SSUTA states have adopted common practices, definitions, and processes, allowing remote sellers to comply at little cost to them, thus removing any "undue burden" on interstate commerce.

Your support for S. 1832 allows SSUTA states like Minnesota-which have implemented the administrative reforms sought by the retail community-to collect the sales tax revenue to which they are already legally entitled.

States should have the right to collect sales tax on sales in their state as long as they do so responsibly by not placing an "undue burden" on interstate commerce. I agree with Tennessee Governor Bill Haslam's recent comments on behalf of the National Governors Association before the U.S. House Judiciary Committee when he stated, "This discussion isn 't about raising taxes or adding new taxes. This is about states having the flexibility and authority to collect taxes that are already owed by their own in-state residents."

I have attached two charts. The first chart shows the magnitude of lost sales tax revenue from 2004 through 2011 in Minnesota, as well as the breakdown across three categories of lost sales tax revenue:

a. Retail/consumer e-commerce sales tax gap—$149 million in 2011

b. Mail order/consumer remote sales tax gap—$55 million in 2011

c. Wholesale/business remote sales and use tax gap—$190 million in 2011

The second chart shows the increasing trend of retail e-commerce sales as a percent of total U.S. retail sales from 2000 to 2012, now at 5.6 percent as noted above.

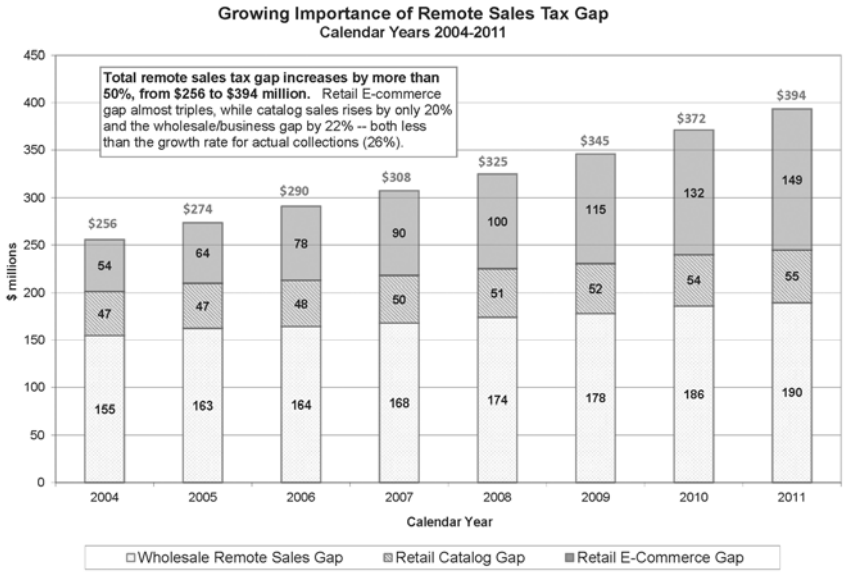
Thank you for your leadership on the Marketplace Fairness issue and for being a true champion for equitable tax reforms, which will benefit not only Minnesota but the entire nation.

Sincerely,

MARK DAYTON,
Governor.

Attachments (2)

cc: Chairman, Senator Jay Rockefeller
Ranking Member, Senator Kay Bailey Hutchison
Senator Al Franken
Congressman Tim Walz
Congressman John Kline
Congressman Erik Paulsen
Congresswoman Betty McCollum
Congressman Keith Ellison
Congressman Colin Peterson
Congressman Chip Cravaack
Congresswoman Michele Bachmann



Senator KLOBUCHAR. Very good. And then also on the record a list of 138 small businesses in Minnesota who recently wrote to me in favor of this bill.

The CHAIRMAN. So ordered.

[The information referred to follows:]

Stand With MainStreet.com

Minnesota imposes a sales tax that brick-and-mortar retailers (and their websites) collect at the time of purchase and remit to the state. Today some online-only retailers (including Amazon.com) are exploiting a loophole that allows them to not collect Minnesota sales tax on these same purchases, placing the burden on consumers to self-report and pay that tax directly. However, few do. This gives online sellers a competitive advantage by not collecting the tax and creating the perception that online-only purchases are "tax free." The Minnesota Legislature is considering a proposal to require large online-only retailers to collect sales tax at the time of purchase like brick-and-mortar retailers are already required to do and to bring fairness to the marketplace. Competition among businesses, whether they operate on the Internet or in Minnesota communities, is important. The proposal being considered by the Legislature establishes fairness for a 21st century marketplace and makes sure that all sellers have the same tax collection obligations.

E-Fairness Supporters

Statewide businesses
Target
Walmart
Home Depot
JCPenny
Best Buy
Creative Kidstuff
Barnes & Noble
Sears
Thrifty White Pharmacy
Walgreens

Small businesses
Hennen's Furniture
Happy Sleeper Furniture
Quality Appliance & TV Center
Robert's Fine Jewelry
Eichorn's Furniture
Brownie Furniture
Jenia's Appliance & TV
Woodwards Books
Puffes Fine Jewelry
Ferrin's Furniture
Red Wing Appliance
Wanshura Jewelers
Johnson-Mertz Appliance
Garon Bros Jewelers
Security Jewelers
First Photo
Bookstore at Fitgers
Ski Hut
Explorations
J Skylark Co. Toys for
Keeps Logan's
Furniture Appliance
Village Co. Master
Jeweler Waconia
Farm Supply
Factory Direct Furniture
Linsk Flowers
Drury's Furniture
Grand Jeté
Schroeder's Appliance Center
Kern's Appliances
Bethany Book & Gift
Cycle City
Bob & Frans Factory Direct
Cattale's Books & Gifts
Uff da Shop
Rick's Home Furnishings
Yetzer's Home Furnishing
Vacuum Cleaner Outlet & Services
Valley Bookseller
Bakkum Enterprises, LLC
Mary's Morsels & Catering LLC
Spicer Bike & Sports
Uncle Hugo's Science Fiction
Bookstore/Uncle Edgar's Mystery
Bookstore
T & M Athletics
Artistic Floral
Diekman's Jewelry
Rhoda's Closet Inc.
Hillary's
Pete's Surplus
Christian Book Store
Glenwood Floral & Greenhouses
Kraning Jewelry Inc.
Jenny & Co
The Framing Place and Gallery
Yarn Harbor
Gem Classics Inc.
Teske's Jewerly Inc.
Adventure Cycle and Ski
Bissen's Tavern
J B Off Sale Liquor
Casey's Bar Inc.
Country Rose Floral
Collins Feed & Seed Center
Liquor Mart
A Johnson and Sons Florist
Kalli's Place
That Special Touch Flower Shop
Strom Clothing Co.
Thomas Liquors
Dar's Pub Inc.
Judy's House of Gifts
Suzanne's Jewelry
Big Guys Bar
Beltone Hearing Care Center
Woodwards Books, Yarns, Fabrics
Anderson Memorials Inc.
Eastside Express Northwedge
Greenhouse Tradewind Products
Art II (Framing
& Art Supplies)
Fleur de lis
Replay MMG
Sleepy Eye Floral and Design
Chapel of Love
Grand Performance
Uncle Louie's Café
OFF Sale Liquor
Artistic Treasures
Phillson Award Etc. LLC
Double J Cafe
Antle's Long Guns & Accessories
Village Liquor
Dan's Dugout
Bremer's Bar Inc.
Shooters Pub LLC
Bill's Repair
Town and Country Café
Stavrakis Jewelers
Wothe Bait
Life in Lavender
Lake City Radio Shack
A&W Consulting
Bloomington Jewelry & Trophy Co.
Brinky's Liquor
C&J Store Country
Floral Crosstown
Market Deb's Snow
Sled Inn Hwy. 25
Liquor
La La Homemade Ice Cream
Mike's Drive-In Liquor, Inc.
Moments On Main
On Sale Liquor
Oriental Orchid
Preston Liquor Store LLC
RMR Inc, Roger's Grove City
Liquor
Slim's Wood Shop
Stogies Discount Tobacco
Trailhead Cycling & Fitness
Nelson OFF Sale
Card Shop
Colonial Laundry, Tara's Sewing
Shop
Witoka Tavern
Doug's Bar
Bud Rose Flowers
The Attic Gallery
Cattales Books & Gifts (new & used
book store)
The Gumdrop Tree
Pioneer Cycle
Buskala's Jewelry
Straight River Sports & Fitness
Van Guilders
Bayside Floral
Waldeland Jewelry & Gift
Soderbergs Floral and Gift
Baby Grand
Peapods
Firsttech, Inc

Business organizations Midwest
Bookseller Association Midwest
Hardware Association Minnesota
Retailers Association Minnesota
Chamber of Commerce Hibbing
Area Chamber of Commerce
Saint Paul Area Chamber of
Commerce

Business organizations (cont.)
Dakota County Regional Chamber of Commerce
Richfield Chamber of Commerce
Minnesota Business Partnership
American Booksellers Association
Alexandria Lakes Area Chamber
Litchfield Chamber of Commerce
Woodbury Chamber of Commerce
Chisholm Area Chamber of Commerce
TwinWest Chamber of Commerce
Burnsville Chamber of Commerce
Metro Independent Business Association

Other
Dakota County Board of Commissioners
Sleepy Eye Herald Dispatch

Senator KLOBUCHAR. Thank you. And, by the way, included in that group is Mary's Morsels and Catering, Big Guy's Bar, Sleepy Eye Floral and Design, and the Chapel of Love. I mention that only because this isn't only about big stores. It is also about small businesses who seem to believe that they will find a way to do this and do this right.

And that actually is my first question of you, Mr. Bercu. In addition to your store in Austin, you also sell books on your website. Is that correct?

Mr. BERCU. Yes.

Senator KLOBUCHAR. And this means that, at a minimum, when you sell a book through your website to a customer in Texas, you're already required to collect the sales tax. Is that right?

Mr. BERCU. Yes.

Senator KLOBUCHAR. But in reality, you already collect sales tax from every state with a sales tax that you sell books in, despite the fact that even if this legislation was signed into law, you would be exempt. But you already do that with other states?

Mr. BERCU. Yes, I do.

Senator KLOBUCHAR. OK. So I'm assuming you——

Mr. BERCU. Apparently with some errors. But I will state that I do collect the sales tax through a data provider that I will be speaking with. I do not do this in my store, and I do not have a gigantic store. I do not do this in my store with a data provider giving me the actual rate at an actual location. That's being done at the back end, and that's being provided to me. It is actually very simple for me, though incorrect, apparently, for Mr. DelBianco. And I will see what has happened with that by talking with that data provider.

But, yes, I do that already, and it's not complicated. And, actually, if I could simply respond to one other thing you said——

Senator KLOBUCHAR. That's fine. Please do.

Mr. BERCU —Senator, is that the idea that I shouldn't be concerned about the other jurisdictions makes no sense to me. If my customer is in this other jurisdiction, I am somehow using public

services, roadways, et cetera, to get my product to that consumer. That's who I'm collecting the tax from, and I'm not collecting it for me. I'm collecting it for their state. It's not that hard.

Senator KLOBUCHAR. And, Mr. Misener, one of the concerns that was raised by Senator Ayotte and others is that it's a burden of complying with this myriad of tax laws. And while I think the testimony we're hearing today is going a long way to showing why this isn't the case, I think that argument also ignores the fact that in the absence of a Federal law, states are passing laws for dealing with the sales tax on a piecemeal basis, which is creating its own myriad of problems. Do you want to describe that to us?

Mr. MISENER. Yes, Senator. Thank you. It certainly is the case that many states have attempted to enact and some have passed unconstitutional legislation to try to solve this state by state. We have opposed that vehemently, because it is unconstitutional. The right to resolve this issue is the right of Congress alone.

I might also point out that the Supreme Court could easily take this case again next week and rule differently. And if the Supreme Court did that, there would be no small seller exception. There would be no simplification. And so right now, the benefit to small businesses of getting the legislation done without a Supreme Court decision is manifest.

Senator KLOBUCHAR. Thank you very much. And I appreciate the chair and the ranking member allowing me to go out of order here because I have to preside. And I wanted to end with this. It's just that not only is this an issue for businesses in our state, small and large, it's also clearly an issue for our state governments and, as I read, with their ability to be able to collect taxes.

It's forecast that it's something like $300 million and some a year in Minnesota. I note that we are today on the fifth year anniversary of the I–35W bridge collapse. Clearly, our states need money for infrastructure, and our businesses need to have an even playing field.

Thank you very much to all of you.

The CHAIRMAN. Thank you, Senator.

Senator DeMint.

STATEMENT OF HON. JIM DEMINT,
U.S. SENATOR FROM SOUTH CAROLINA

Senator DEMINT. Thank you, Mr. Chairman. We hear a lot from the group here today of the term, fairness, and that we need to be fair to different retailers, tax them the same. I've had a chance to work with a lot of retail businesses. I've been in the marketing business most of my life.

And there are a lot of different business models with different cost structures. I think all of you know that. You can be a free-standing retailer, where you have to be a destination, much different from locating in a mall, where they help attract the people, but your cost of doing business is very different.

You could locate downtown and pay city taxes, but you get some of the advantages of sanitation services and fire and others that you might not get in a county location. Or you could open a retail store in an outlet on an interstate highway, and you locate it across a state line in a low tax area, which is not fair to those states

around it, because people from many states come to that outlet to shop. And they pay the tax where they buy it, not where they're going.

We talk about fairness. But we don't require bricks and mortar retailers to pay taxes based on where the consumer is from. We don't check their ID. Let's be clear about what this bill does. It mandates that online companies with no physical presence in a state collect sales taxes for any state that demands it. So this is a mandate on businesses.

And we talk about this being owed by consumers, but if the tax is not collected, the consumer is not audited. The business is audited. If you don't collect enough taxes that you're supposed to, you'll pay it. Your consumers won't.

I've been here a long time, and I've seen many businesses that used to be small. They grow, and then they use their political clout to come here to advantage themselves and to erect barriers to entry for smaller companies.

Mr. Misener, you've laid it out very clearly. You've said that this is very difficult for small companies to comply with. But they can use companies like yours and eBay, which basically forces a lot of small companies that could otherwise be marketing on their own to go through these major companies.

One of the great things about the Internet is the entrepreneurs that have been developed on the Internet and able to market direct to consumers. They don't have to pay the cost of a mall. They don't have to pay—but, see, it's a different business model.

We talk about the roads or whatever. Sales taxes are collected, and they pay for education and other things in that state. But we've never had a situation where we as a Federal Government require a business to be subject to every other state. Are we going to ask those businesses to comply with labor laws, to pay income taxes based on business that they've done?

It's not a new concept. We've had different business models for years. There have been corporations that primarily do business in South Carolina, but they incorporate in Delaware where the corporate taxes are lower. But we don't have the right to charge them income taxes based on the business they do in South Carolina. They picked a business model and located somewhere else.

And I think what we're doing here is trying to suggest that all these business models are the same. Every retailer is different, whether they're bricks and mortar or online. And if someone picks an online business model, just like Amazon was years ago—and, Mr. Misener, you know that when you had no physical presence in other states, you tended to support the status quo.

But now that you've changed your business model to build a location so you can really leapfrog some of your competitors, not only are you an online business, but you can do same-day delivery by having a physical presence. Now that you're going to have to pay taxes in all of these states where you have a physical presence, you want to come back and tax those other companies that don't.

The online companies don't have police service and fire service and sanitation service and municipal parking and all of the things that come with that business model. We can't make them the same.

And so fairness being that we tax them the same is inconsistent with everything else that we're doing here.

And, again, the more testimony I hear—oh, they're only subject to one audit a year—from 50 states? Are they going to have to fill out a sales form and send to every state and be taxed? They won't have any problem, I guess, if they've done that through one of these service companies.

Mr. Misener, how much are you going to charge your marketers to collect this sales tax, percentage wise?

Mr. MISENER. We already do, and it's 2.9 percent of the tax collected, which is not a profit for us. So this is not a profitable business. This is part of the host of services that we provide to our third-party sellers, which number over 2 million. So we are an enabler of small businesses. Over 2 million small businesses sell through us.

Senator DEMINT. Three percent, about half the whole sales tax in South Carolina just to collect it.

Mr. MISENER. No, sir. It's a percent of the sales tax. So on a $100 purchase in my home state of Virginia, that's $5 in tax and that's about 15 cents.

Senator DEMINT. So they'll have to bill that cost into the cost of their product.

Mr. MISENER. Like small businesses offline do, of course.

Senator DEMINT. Oh, sure. But isn't that putting them at a disadvantage? They're actually paying more tax now than brick and mortars.

Mr. MISENER. I'm sorry. I don't understand that.

Senator DEMINT. Well, you're adding 3 percent to the sales tax that they would pay in South Carolina.

Mr. MISENER. No, Senator. That's actually a misunderstanding, and I'm sorry I wasn't clear. That 2.9 percent is covering our out-of-pocket costs for the credit card processing fees. And so the brick and mortar retailer who swipes the card has the same fee structure. They're paying credit card companies money out of their pockets for the——

Senator DEMINT. So you're not charging them anything to collect the sales tax on their behalf?

Mr. MISENER. We are not making a profit on it.

Senator DEMINT. But you are charging them.

Mr. MISENER. Yes, sir. Why would we pay Visa for that privilege?

Senator DEMINT. Well, I would encourage my colleagues to look back at this. The Federal Government cannot make retail business models the same. Whether they're bricks and mortar, online, or some combination, which we're seeing all over the country, they pick a business model with different cost structures. We cannot make all those the same. A lot of businesses have decided to do business different ways.

For us to come in and change the rules now to subject every online business to 50 states, I think would be an unprecedented action on our part. I certainly plan to oppose it, and I would encourage all of you to think. Is the next step—does an online business need a business license in South Carolina if they're located in New Hampshire? Should they collect income tax if the people of New Hampshire are using—I mean, they're making a profit.

What about tort laws? What's the next step? I think we are setting—we've got a precedent that we're establishing here that's going to open a door that I think all of us are going to regret.

Thank you, Mr. Chairman.

The CHAIRMAN. You were two and a half minutes over.

Senator DEMINT. Thank you for your courtesy.

The CHAIRMAN. No, I'm just trying to keep some people happy here.

Senator Begich left briefly. He should theoretically be the next one on our side, but he left, so he has to be punished.

[Laughter.]

The CHAIRMAN. So it's going to Senator Pryor. And then let me say——

Senator BEGICH. I was taking care of a West Virginia constituent problem, but that's OK.

[Laughter.]

The CHAIRMAN. So Senator Begich has to speak. Senator Thune is gone. Senator Blunt, Senator Boozman, and Senator Cantwell and Senator Pryor. And I'll do it in proper order.

STATEMENT OF HON. MARK PRYOR,
U.S. SENATOR FROM ARKANSAS

Senator PRYOR. Thank you, Mr. Chairman. And I would like to just start by making a comment on what Senator DeMint said. I do agree completely that there are different business models, and not every single business model should be treated the same way.

But I do think in a retail setting, one thing we—another way to look at it, I guess, would be we could look at the point of sale. And in a traditional bricks and mortar transaction, when the customer walks in the store, that's the point of sale—the customer and the store in the same place.

In an online transaction, you could say—and I think the point of sale is actually at the person's computer. He's sitting in his home. To me, that's the point of sale, and that's why I'm OK—that's one of the reasons why I'm OK with the local sales tax applying.

Let me start with you, if I may, Mr. DelBianco. You said in your testimony a few moments ago that your clients, your members, don't get any benefit from paying a local sales tax. Is that right?

Mr. DELBIANCO. I said they will be forced to collect the tax and remit and file for states where they don't enjoy any local services. After all, they ship things through common carrier, like a UPS or a post office. But they send no trucks or sales reps into those states.

Senator PRYOR. Well, I disagree with you on that, because the product that you're shipping is carried on a truck, a delivery vehicle like UPS or FedEx, and that UPS or FedEx truck is using the local streets that are paid for by local taxes. And if that package is dropped at someone's door and it is stolen, it's the local police that come and investigate. They don't call you back in your home state. They go where that delivery is made.

And, also, likewise, if you use FedEx or UPS and there's a handling center there where they're loading their trucks and doing all that, if there's a fire, it's the local fire department that shows up

there. I think you are getting benefit by the customer paying local sales tax there.

Mr. DELBIANCO. Senator, FedEx and UPS in those cases are paying plenty of taxes—property taxes, payroll taxes, income taxes—in the states where they operate today. That's the whole notion of common carrier. And, of course, Congress is free to say that we don't agree with Quill, because Quill said—the case said that because the office products company used common carriers, they didn't have sufficient physical presence.

So Congress has the power to do so, but it also has the obligation, I think, to protect interstate commerce and require true simplification, not just token simplification. Senator Enzi and Senator Dorgan years ago had 16 significant minimum simplifications baked into the bills that would authorize Streamline. Well, they're all gone now, because the states figure that that's a little hard to do. We now have a bill with merely token simplifications, and we still permit all of these jurisdictions.

Senator PRYOR. Well, I don't necessarily agree with what you said, but I do want to move on to my next question. And that is, you know, we talked about just a moment ago your example of using Mr. Bercu's website to purchase a book and getting the wrong sales tax. I'm not that familiar with the sales tax in Virginia and how that works in buying something online through his store.

But, to me, that is another reason—I think you've made another point on why we should support this legislation, because this legislation would protect a retailer that has made a mistake, whether it's inadvertent or—you know, however that works, it would protect the retailer so he doesn't have the liability.

Mr. Bercu, do you have any comment on that?

Mr. BERCU. Well, yes. That's exactly what the act provides. The other thing about this is I believe that, with the simplified procedures that the act contemplates, there are going to be a whole slew of people getting in the business of data provision. There will be other companies, and the costs will go down, just like every other thing that is suddenly available. Suddenly there will be a market, and suddenly there will be a value, and suddenly there will be people who decide they can beat Amazon's 2.9 percent and do some other deal to sell that data or sell those services to individual retailers.

So I don't see this going forward as being a problem. And I guess the most salient factor is what one of the senators pointed out earlier, that $500,000 exempts 99 percent of the people doing online business in the first place. That's a substantial number of people doing online business, and I believe that the 1 percent that are left probably already are taking steps to make this not be a problem.

Senator PRYOR. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Pryor.

Senator Boozman.

STATEMENT OF HON. JOHN BOOZMAN, U.S. SENATOR FROM ARKANSAS

Senator BOOZMAN. Thank you, Mr. Chairman.

Mr. DelBianco, you were talking about a lot of pressure coming from the big box retailers in regard to getting this done. What do

you say, though, to Main Street Interiors in Van Buren, a town adjacent to where I grew up in Arkansas? They have the problem of starting out 8.5 percent behind. And so we've been talking about fairness and stuff. How do you compete in that situation?

Mr. DELBIANCO. The big box retailers who already have to collect from their websites in every single state today would benefit from even a tiny bit of simplification. But this Interiors company—when they sell to customers in other states, other than Arkansas, they would be incurring brand new obligations to collect for all those other states when they're taking advantage of the opportunity to ship things at a lower price to customers in other states.

For them, there's nothing remotely simple about having to collect and file for all those different jurisdictions. So most businesses on main street today use the Internet as a way of surviving and competing against the big box stores and by Amazon.

Senator BOOZMAN. Why does the vast majority of small businesses in Arkansas and many of our other states disagree with that? I mean, they're overwhelmingly—small business is overwhelmingly for this.

Mr. DELBIANCO. Small business, small retail, has been really taking it in the shorts for decades from shopping malls, from the advent of big box stores, and certainly by giant retailers. Small business is under assault, and the small business retail environment has changed dramatically. It's now very top heavy as opposed to being bottom heavy.

So those businesses are under assault, and they might well believe that that price difference associated with the consumer who wants to save sales tax will be the answer to all their problems. But there's no evidence, other than anecdotal, that consumers will go online to avoid sales tax. A few do, Senator, and I'm aware of that. A few do.

But the vast majority of people who buy online—probably your family included—we buy online for convenience and selection, and we pay for the shipping. And often we pay sales tax for 17 of the top 20 e-retailers today.

The CHAIRMAN. You haven't answered his question.

Senator BOOZMAN. Well, again, really what you're saying is that the vast majority of retailers who are overwhelmingly supportive of this—they don't really understand why they're not doing as well as they would like. I'll tell you why I think they're not doing it.

I've got three daughters. The youngest is 26. The oldest is probably 33 or 34. They go into a store. They get their iPad out, and they start doing the prices. And when they compare a price online, where they don't have to pay 8.5 percent more compared to the price there, there's definitely a differential, and that's making a difference, in my way of thinking, and, again, to the vast majority of small businesses throughout America.

And that's why the compact states have been so successful in states like Arkansas and Texas in getting these things passed, in the sense that the states have voted to do this.

Mr. DELBIANCO. Senator, Texas is not a member. Texas got Amazon to collect simply because Amazon has a distribution center in Texas.

Senator BOOZMAN. Well, Arkansas is, and many other states are.

Can you comment on that, Mr. Peterson?

Mr. PETERSON. Thank you, Senator. Your retailers are most certainly impacted by the price differential that comes from that sales tax. There's no question whatsoever. Consumers expect the retailer to collect the sales tax. They don't even think about the sales tax as an obligation of their own. That's an obligation of the retailer.

So they look at the bottom line. Is that price cheaper than what I can get somewhere else? And they're certainly going to buy where there isn't a—where there's a price difference. They don't think about that as they're cheating the system. They just think, well, the price is cheaper. It's 8.5 percent cheaper. Why wouldn't I buy here?

Getting to Senator Ayotte's point a little while ago, the software companies that the Streamline states have certified do everything that she's concerned her New Hampshire retailer is left to do on their own. It figures out what the sales tax rate is. It knows what's taxable. It knows what's exempt. It keeps track of sales tax holidays. It keeps track of whether or not shipping is taxable or shipping is exempt. It files the sales tax returns for that business and makes the sales tax payment for that business.

And if that person is audited—and there isn't a business in this country that gets audited by 50 states every year. No business in the country does. Wal-Mart doesn't get audited by every state every year. These companies handle the audit defense.

Senator BOOZMAN. How many states have gone through the process?

Mr. PETERSON. Twenty-four states, sir.

Senator BOOZMAN. Twenty-four states. OK.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Boozman, very much.

And now the noble senator from Alaska.

STATEMENT OF HON. MARK BEGICH,
U.S. SENATOR FROM ALASKA

Senator BEGICH. Thank you, Mr. Chairman. Thank you very much. Let me say a couple of things first. This is an issue, as a former mayor, I dealt with more than I wanted to in the Municipal League as well as the U.S. Council of Mayors, but also as someone—and I was listening to your commentary. I'm probably one of the few that can comment on this in this way.

We own five retail shops, and they're a variety of shops. My wife started them. She owns them and operates them. But we have five different retail shops, and so we're a brick and mortar business, but I also have a brother that runs an online business, which is not in the ether, either. There is some location.

So I come to this with kind of mixed views on it. But I think there is a basic fairness issue here of how do you ensure that if you're a retailer—it doesn't matter if you're a brick and mortar that's invested quite a bit in your community and you're doing a lot of things in your community. You're paying for the roads and everything else that goes along with it. And then you have to compete against an online, which avoids this issue and doesn't have to deal with the sales tax.

So I hear your commentary. I'm not sure I buy it, just so you know. And I come from one of your people. I'm a retailer, and I've been in the retail business myself. My wife has, like I said, five different stores. So we're not top heavy, as you described. I wish we were. It would make our life a lot easier.

But we innovate all the time with the products and services we do, but when you then have to compete against someone online with the exact same product, and they can do things to undercut you, it does create a competitive edge that we do not have and can't gain. So you can tell me all the research you want to do. I'm telling you from a life of 30 years in the retail business. So let me put that over there for a second.

I guess my question is the small business operator—because this bill does—I'm not sure of the percent, but I'm just going to use the number, $500,000. The question I have to anyone who wants to answer it—is $500,000 the right number, knowing as time progresses, that number is stale, is stagnant? Does it have to be adjusted? Is it the right number? And is it the number that over time will clearly protect most of the small businesses that don't have to deal with this issue?

I guess everyone wants to answer. So I'm going to go quickly down the line.

Mr. DELBIANCO. Senator, if you took a look at the top 500 retailers last year, they were responsible for over 90 percent of the uncollected sales tax. And that starts with Amazon at the top end at $50 billion and a small company called Summit Sports at $15 million at the bottom end of that. So businesses under $15 million could be protected and the states could still collect 90 percent of their sales tax. And that kind of a number would adjust over time if you wanted to target it on the top 500 collecting. Those are the businesses that can afford it.

Senator BEGICH. That data—will you share that with me?

Mr. DELBIANCO. It's in my testimony, sir.

Senator BEGICH. Great. And the reason I say this—when I was mayor, we changed the law, because we used to tax everybody's inventory. And what we found is for 96 percent of the people we were taxing, it cost us more to collect it than what we were receiving. So we created an exemption—all but the top 4 percent and got a big chunk of our money, in essence. So your point is a good one. Next?

Mr. PETERSON. Thank you, Senator. The half a million dollars that's in the Marketplace Fairness Act was arrived at by looking at where it was cost effective for states and retailers to file sales tax returns. But it was looking at the world that exists today. Six months after this bill passes, a year after this bill passes, sales tax administration software will be ubiquitous. It will be everywhere. The cost of collecting will go down radically.

Now, the people I represent aren't advocating a different rate. But the reason it doesn't exist today is because there is no law that requires it to exist. Once that law happens, this will be everywhere, and the cost of administration goes down radically.

Senator BEGICH. It's like my son just got—he's 10. I forget what it's called, but the little piece that you can hook up to your iPad

and Visa—he wanted to get it for my wife to help her do more charges. So I'll leave it at that.

Mr. BERCU. I agree with Mr. Peterson. And, frankly, when credit cards started, there was a charge, and there still is a charge, for credit card processing. Every one of us in retail pays that charge. It is a cost of our doing business. You know that if your wife has stores.

Senator BEGICH. My wife tells me about it.

Mr. BERCU. And we worry about it, but that is a cost of our businesses. And if we have to incur a slight cost to deal with sales tax remotely, because we're selling something remotely, it strikes me as eminently fair and eminently fair for us to bear that cost. And so I don't see it as a big problem. I definitely agree with Mr. Peterson that in the future, once this bill is enacted, we will see this software available all over the place, certified all over the place, and the cost will have gone down to be—yes, it will be a cost, but it will be a tiny one that no one will have any problem bearing.

Senator BEGICH. Last person.

Mr. MISENER. Senator, very conservatively assuming 5 million online sellers in this country through eBay, Amazon, through their own channels, only 1 percent of those sellers sell more than $150,000 a year. So we're already talking about——

Senator BEGICH. Online.

Mr. MISENER. Correct. Interstate. So we're already talking about a fraction of 1 percent that would be affected with the $500,000 carve-out. We would prefer one lower, but we're willing to live with the $500,000.

Senator BEGICH. Understood. Thank you all very much, and I appreciate it.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Begich.

Now, Senator Blunt.

STATEMENT OF HON. ROY BLUNT, U.S. SENATOR FROM MISSOURI

Senator BLUNT. Thank you, Chairman. I have a statement for the record.

[The prepared statement of Senator Blunt follows:]

PREPARED STATEMENT OF HON. ROY BLUNT, U.S. SENATOR FROM MISSOURI

Thank you, Chairman Rockefeller and Ranking Member Hutchison, for holding today's hearing on the Main Street Fairness Act. I also want to thank our colleagues Senators Durbin, Enzi and Alexander for taking the time to appear before this committee on behalf of this important legislation.

The debate over online sales tax collection, something we've been talking about in Congress for more than ten years now, hinges solely on fairness and states' rights. I strongly believe that states should have the right to decide to collect or not collect sales taxes for online transactions. This 10 page bill would simply give them that right—and keep up with changes in technology and the way consumers make purchases today. States lost this right 25 years ago due to a Supreme Court decision well before Internet sales took place or companies like Amazon, who is here with us today, existed.

We all know very well that our current Federal and state tax systems are overly complex and burdensome. As we gear up for what I hope will be meaningful reform of our tax code, I believe this is the right moment to also consider allowing states to level the playing field for the $4.7 trillion retail industry and helping states access the $23 billion in uncollected sales tax that is owed.

When I talk to consumers in Missouri about this issue, most are shocked to hear that they actually are required by state law to pay taxes for their online purchases. As a matter of fact, a study conducted by The Winston Group found that 65 percent of people believe that "online retailers are required to collect sales taxes from customers just like brick-and-mortar retailers do." These same voters, 72 percent of them, overwhelmingly view sales tax collection as the seller's responsibility only.

If a responsible taxpayer in Missouri wants to report and remit taxes for their everyday purchases on Amazon.com such as $65 worth of DVD movies, they would need to download a form, fill it out, and write a $3.12 check to the Missouri Department of Revenue. By the way, my staff was able to quickly determine the sales tax example I just gave by logging on to JCrew.com and putting a $65 item into the shopping cart feature, along with a Missouri zip code. It's really that simple—thanks to Paypal, which is owned by Ebay, an opponent of this bill.

I can't understand why Ebay argues against this legislation, which would help both states and retailers alike access affordable software to calculate sales tax and increase their annual revenues. This bill is good for states that need to maintain their infrastructure and keep other tax rates competitive as they look to attract new businesses. The effects are equally positive for small retailers who wish to grow and hire more employees but need software to assist them in managing the checkout process.

When I think about the issue of fairness, I recall a recent conversation I had with a reporter in St. Louis whose wife knows a local bridal shop owner. That brick-and-mortar bridal shop loses thousands of dollars in dress sales each month as customers come into the store to find a dress they like but then leave to purchase that *same* dress online from a seller without 'nexus' to their state, thereby avoiding sales taxes. This same example is true for countless large ticket items and so many other purchases small and large.

On the heels of the House Judiciary Committee hearing last week, I'm pleased that this committee is thoroughly discussing this topic and look forward to each of the witnesses' testimony today.

Senator BLUNT. I'm glad to be a co-sponsor of the bill. I think I'm going to add to that, in case somebody else hasn't, a pretty good outline of conservatives, like the Chairman of the American Conservative Union; Governor Mitch Daniels; Chris Christie; Congressman candidate for Governor, Mike Pence, in Indiana; former Governor Haley Barbour, all making the point that if we don't do this, the government is really just picking winners and losers.

I remember when we first introduced this bill, I had a news conference in St. Louis, and the TV reporter who was interviewing me, immediately when we were done, said, "You know, my wife says she has a friend who has a bridal store, and people constantly come in, try on the dress, write down the number of the dress they want to order, and then clearly are ordering it somewhere else. And she's convinced the only difference, more times than not, is the sales tax."

And as somebody else was suggesting, maybe Senator Pryor, a person came in, and in this case, in this store, parked on a public street, used the police protection that's available in that community to come in, and, of course, used the store itself, but also used all the taxpayer things that they don't share. And I think a lot of conservatives share that.

Mr. Peterson, the *Quill* case has been mentioned a lot. In the Supreme Court ruling in 1992, they said—and I'll put this with my statement, too. They said, quote, "This aspect of our decision is made easier by the fact that the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve." Do you want to comment on that?

Mr. PETERSON. Thank you, Senator. The states were very heartened when the Supreme Court said in 1992 that their decision really rested on the interstate commerce case, because you do have the authority. And at that point in time, the states knew that this was going to be a negotiated settlement—what do they need to do to convince you that this is something that you should give to them—knowing full well that there would have to be obligations put on them, because you're not going to pass something that just gives them carte blanche. And I think some of the statements made by the other senators give some effect to that.

Quill was decided long before the Internet because it was stare decisis of 1967. When the *Bellas Hess* case was created in 1967, it was a catalog case, and I think it was reasonable for the Supreme Court in 1967 to say that perhaps the technology didn't exist for a retailer to have a reasonable chance of complying.

In 1992, it was getting much better. In 2012, the technology is immensely different than it was in 1992. It is immensely different today than it was when we started Streamline. We didn't even imagine when we started Streamline in 2000 that the software that the certified service providers provide today would do as much as it does today, because we couldn't even imagine that kind of technology existing in something as simple as this.

This is a map of the United States with every sales tax rate on it. I can push any spot in this map, and it'll tell me what the exact sales tax rate is for that jurisdiction. This is relatively simple stuff.

Senator BLUNT. Did anybody on this panel submit the numbers to the Committee on the amount of e-commerce this year, estimated next year—I mean, huge growth. It's up 16 percent last year from 2010. The estimate is it will be up another 15 percent this year from 2010 up to $224 billion.

Mr. DelBianco, the one other thing I want to pursue—your thought is if we did go in this direction—I understand all of your arguments not to do that—that we could have a bigger exemption number.

And then, Mr. Misener, I think you believe the number may be too big already. And if the two of you would, just talk about that a little bit.

Mr. DELBIANCO. Senator, it's not just that. There are three elements of this that have always been there in Streamline. The first was true simplifications. The conditions that were in place when we started Streamline have all disappeared. They're now allowing thresholds, multiple sourcing rules, separate returns, separate audits for every state. There was an idea of one rate per state. That's gone. There's no requirement for vendor compensation.

The first thing is put the true simplifications back in, and I put it in my testimony. The second is a strong small seller exception. And the third is enforcement mechanisms, because if this thing starts going awry, and Missouri-based businesses tell you, "Please get me out of this," that business can't try to hold the other 45 states to the standards of simplification. There's nothing in this bill to allow a business to sue for enforcement against the other states.

Senator BLUNT. All right. And I think I'm out of time. And I'll look at the comments you previously made on this, Mr. Misener.

Thank you.

The CHAIRMAN. Senator Blunt, you were waving something around, talking about putting it in the record, and I want to put something in the record. Tell me what to put in the record.

Senator BLUNT. In the record I'd like to put this statement, what conservatives are saying in support of the Marketplace Fairness Act, and then a specific part of the Supreme Court decision, where they say not only is Congress may be better qualified to resolve this, but has the ultimate power to resolve it. So I'll add those two things to my statement.

The CHAIRMAN. It is so ordered.

[The information referred to follows:]

WHAT CONSERVATIVES ARE SAYING IN SUPPORT OF S. 1832, THE MARKETPLACE FAIRNESS ACT

"There is no more glaring example of misguided government power than when taxes or regulations affect two similar businesses completely differently." *Al Cardenas, Chairman of the American Conservative Union*

"The only complete answer to this problem is a Federal solution that treats all retailers and all states the same." *Governor Mitch Daniels*

"I too—along with governors like Governor Daniels and others—urge the Federal Government and the Congress in particular to get behind Senator Lamar Alexander's legislation to allow states to be able to make theses choices for themselves . . ." *Governor Chris Christie (NJ)* 5/31/12

"Congress should not be in the business of picking winners and losers." *Congressman Mike Pence*

"Since the Quill ruling, at least two facts have changed: (1) the proliferation of computers to calculate taxes due on sales—just as shipping costs are determined based on Zip Code—and (2) a state agreement on streamlining and simplifying sales taxes so that it is easier to collect and remit sales taxes wherever a company does business." *National Governors Association* (11/28/2011)

"There is simply no longer a compelling reason for government to continue giving online retailers special treatment over small businesses." *Former Mississippi Governor Haley Barbour*

"Current policy grives remote sellers a price advantage, allowing them to sell their goods and services without collecting the sales tax owed by the purchaser. This price difference functions like a subsidy." *Hanns Kuttner, Hudson Institute*

* * *

The Supreme Court actually noted in their decision that this disparity in tax law should be clarified by Congress. They stated:

> "This aspect of our decision is made easier by the fact that the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve. No matter how we evaluate the burdens that use taxes impose on interstate commerce, Congress remains free to disagree with our conclusions . . . Accordingly, 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."

The CHAIRMAN. Gentlemen, thank you very, very much. It's very strange for me, because, in a way, it strikes me as such a simple matter, a fairness matter, a simple matter. The software has already solved most of it. Has all the software been coordinated? I know not. But I worry not. And it became intensely sort of mathematically, algorithmically difficult about halfway through, which I sort of couldn't understand and didn't worry about.

So I want to thank you. This is a very important subject. People care very strongly about it, as you can tell. You've taken your time

to come and enlighten us and to be forthright with us, which you all have. You've been an excellent panel. I thank you, and this hearing is adjourned.

[Whereupon, at 4:10 p.m., the hearing was adjourned.]

A P P E N D I X

PREPARED STATEMENT OF HAMILTON DAVISON, PRESIDENT AND EXECUTIVE DIRECTOR, AMERICAN CATALOG MAILERS ASSOCIATION

The American Catalog Mailers Association (ACMA) thanks Chairman Rockefeller, Ranking Member Hutchison, and the Senate Committee on Commerce, Science, and Transportation for this opportunity to present its views on the efforts of states to impose tax and tax collection obligations on retailers located outside of their states and who have no physical presence in those states, all per the Marketplace Fairness Act, S. 1832. The bill would give states the authority to require out-of-state businesses to collect sales or use taxes. Such efforts represent neither Federal nor state tax reform, but merely states seeking to impose a 1930s tax regime on 21st Century commerce rather than reforming their tax regimes and seeking Congressional help. Effectively, states are seeking to impose business activity taxes on companies with no physical presence, no employees, and no political voice in the state. Such a move is bad for the economy, hurtful to the affected companies, moves the marketplace toward less equity, and fails to solve acute revenue issues for states and municipalities.

Founded in 2007, ACMA is the only industry association that advocates specifically for catalog marketers. As the primary voice of the Catalog Industry, ACMA represents its members on issues that directly concern their immediate and long term commercial interests such as tax issues, postal rates, regulations and technical matters; environmental issues; and regulatory and government relations

ACMA is also a member of TruST, the coalition for True Simplification of Taxation, a recently-formed group whose association members are all filing written testimony that ACMA has read and concurs with. More information on TruST can be found at *www.TrueSimplification.org*.

As part of this written testimony and our presence at the hearing, ACMA would like to respond to the charge "real companies do not care about this issue." To illustrate how erroneous a claim this is, ACMA has gathered more than 120 letters from remote marketers—primarily companies that sell via catalogs—all of whom explain in specific detail the harm this bill would cause their companies, growth, and most notably their employment. It is notable that this quantity of letters was assembled in only a few business workdays between the notice of last week's House Judiciary Committee hearing on H.R. 3179 and the deadline to submit that testimony. This underscores the veracity of opposition to that bill as well as S. 1832 and clearly addresses concerns that no real opposition to this change exists.

1. Background

ACMA would like to address the current movement rallying behind the so-called Marketplace Fairness Act. The bill is hardly fair and would do much harm to the marketplace. It presents a serious threat to catalog, online, and other direct marketers because it would require the collection of sales taxes in more than 9,600 state and local tax jurisdictions, with differing rates, taxable product categories, definitions, sales tax holidays, and reporting and audit requirements. If enacted, it would result in lost sales, confused customers, daunting administrative burdens, repetitive audits, and expensive assessments without impartial recourse. The market value of direct marketing businesses would be similarly affected.[1]

The argument that current nexus standards result in an "uneven playing field" is patently false. National retail chains receive many state and local tax benefits and other incentives to locate stores in particular areas. These include rebates of property and sales tax (TIFs), subsidies for utility lines, training allowances and tax deductions for new hires, etc. Employees of businesses located within a jurisdiction use education and public services. Remote sellers get none of these government ben-

[1] Abe Garver, Focus Investment Bankers as originally published on Seeking Alpha on October 9, 2011 and also found at *http://www.focusbankers.com/publications/articles/Valuations/articles webonlyretailers.asp*

efits, yet would be burdened with collection of the tax to fund these subsidies. In fact, remote sellers are obliged to pay these taxes whether or not they collect them from customers, effectively making this a new tax on remote marketers.

The U.S. Supreme Court in *Quill Corp.* v. *North Dakota,* 504 U.S. 298 (1992), ruled that without specific authorization from Congress, states could not impose tax collection burdens upon remote sellers that have no "physical presence" as this would interfere with interstate commerce. Moreover, if allowed by Congress, the myriad of state tax jurisdictions with resulting variance in rates, definitions, and audits would create a complex and administratively costly nationwide sales tax collection system. The costs of that collection are a tax on the out-of-state business.

2. Hardships on Businesses

Consider the potential situation of several ACMA members:

1. Dr. Leonard's Healthcare Corp., based in Edison, NJ. This 40-year-old, privately-owned and operated company is very much the catalog mail order equivalent of a main street store. Dr. Leonard's provides clothing, undergarments, general merchandise, healthcare related products and shoes tailored to meet the special needs of mature customers from across the country. A sizable number of Dr. Leonard's customers are in their 70s, 80s and even their 90s. More than one-third of the company's orders still come in an envelope with check enclosed. Many of their customers rely on mail order purchases of products from Dr. Leonard's that are simply not available locally or are of a sensitive nature, and a large majority of their customers do not have access or are not comfortable using a computer or the Internet to order.

Dr. Leonard's operates out of a several states and on the order form of all Dr. Leonard's catalogs is a note indicating "residents please add applicable sales tax for NJ, NY, NE, OH, there is no sales tax on clothing and shoes in NJ". (See Appendix I for a picture of a Dr. Leonard's order form.) Many of Dr. Leonard's customers get this wrong either by paying the wrong rate or not paying the tax at all. Imagine if the company's catalog order form had to have a list with the tax rates from more than 9,600 taxing jurisdictions for customers to decipher. It would be impossible for Dr. Leonard's to explain the tax instructions across all the different jurisdictions in the limited space available on a printed order form. And if the older consumers the company serves are confused on how to calculate the tax, or which rate should apply, there's a very good chance they just won't order at all.

For the elderly consumer who is confused with what's going on with sales tax, Dr. Leonard's would end up absorbing the unpaid tax rather than chasing after customers for the unpaid or under-paid tax. The significant harm to its business in chasing after customers for unpaid or incorrectly remitted sales tax would be twofold: (i) the cost burden of collecting from their customers would be substantial and unsustainable, and (ii) the confusion, irritation and negative feelings its customers would have toward the company over their shipments being held up pending payment of sales taxes would cost the company many lost orders—and customers.

As a small company, Dr. Leonard's would also face the tremendous burdens of trying to figure out whether each transaction's tax is correct or not, and remitting it to then being subject to sales tax audits from all those different taxing jurisdictions.

2. Littleton Coin Company, based in Littleton, NH. This fairly small catalog company was founded in 1945 after its founder Maynard Sundman returned from World War II. Littleton Coin allows Americans across the country the opportunity to enjoy the hobby of coin collecting from the comfort of their homes. In addition to Littleton's mailed catalogs, customers see can find its products in print advertisements in newspapers and magazines. They can also use Littleton's "coins on approval" service where the company mails customers coins for them to review at their leisure at home and then decide whether to buy them or send them back to the company.

Littleton's customers have aged with the company. More than one-third of its customers are 65 or older. More than two-thirds of Littleton's orders come through in the mail. And more than two-thirds of the mailed-in orders are paid by check.

This would be impossible for Littleton Coin to properly explain the tax calculation in its print advertisements, for which space is at even more of a premium than on its catalog order forms. This is a critical part of Littleton's business and any customer confusion in this area would severely damage its business, and its relationships with customers.

3. National Wholesale, based in Lexington, N.C. This 60-year-old, family-owned and operated company that provides a full line of clothing, undergarments and shoes tailored to meet the special needs of mature female customers from across the country. A sizable number of National Wholesale's customers are in their 70s, 80s and even their 90s. More than one-third of the company's orders still come in an envelope with check enclosed. Many of its customers rely on mail order purchases

of products from National Wholesale that are simply not available locally, and a large majority of their customers do not have access or are not comfortable using a computer or the Internet to order.

Like many catalog marketers that operate out of a single state, on the order form of all National Wholesale catalogs is a note indicating "North Carolina residents please add 6.75 percent sales tax." (See Appendix I for a picture of a National Wholesale order form.) Despite this simple directive, many of National Wholesale's customers still get this wrong either by paying the wrong rate or not paying the tax at all. Imagine if the company's catalog order form had to have a list with the tax rates from more than 9,600 taxing jurisdictions for customers to decipher. It would be impossible for National Wholesale to explain the tax instructions across all the different jurisdictions in the limited space available on a printed order form. And if the older consumers the company serves are confused on how to calculate the tax, or which rate should apply, there's a very good chance they just won't order at all.

For the elderly ladies who are confused with what's going on with sales tax, National Wholesale would end up absorbing the unpaid tax rather than chasing after customers for the unpaid or under-paid tax. Like Dr. Leonard's and Littleton Coin above, attempting to chase customers for the correct tax amount or delaying shipments while discrepancies are resolved is not feasible. Thus, collecting and remitting the complex tax schemes of over nine thousand jurisdictions will cause significant harm to their business and customer relationship.

4. The Country Store, based in Chelmsford, MA. The Country Store catalog contains clothing, jewelry, and home goods all uniquely targeted at an older clientele with merchandise not available in stores. More than 66 percent of The Country Store's customers are over 65 years of age, and 32 percent of its customers place mail orders with checks enclosed. Similarly, The Country Store also would have to either simply pay the sales taxes it would be unable to collect from its customers or risk confusing or losing its customers altogether.

5. Miles Kimball Company, based in Oshkosh, WI. Nearly two-thirds of this company's customers are 65 years of age or older; in fact, almost half its customers are 70 or older. Among all its customers, one-third of them still make their catalog purchases by mailed-in orders using personal checks. Needless to say, Miles Kimball faces the same impossible task of having to explain the assorted taxing jurisdictions as National Wholesale does.

3. Puts an Entire Market Sector At Risk of Failure

Although a majority of catalog customers pay by credit card and a significant number of such customers order online, the education and conversion processes for collecting from so many taxing jurisdictions around the country are almost as difficult as the ACMA members referenced here.

Some seeking to overturn the *Quill* precedent legislatively claim that this matter can be handled quickly and efficiently with free look up software, or that concerns of complexity and cost are overstated. This simply is not the case. Each remote marketer has invested substantial resources to build enterprise software systems that run their businesses. Everything that touches or relates to the order flow or the revenue flow of the business is affected including those modules that track inventory, take orders and maintain order history, and bill customers to collect revenues. All company legacy systems need to be modified to account for this change, imposing a significant conversion burden on remote marketers. Also required are ongoing maintenance costs to keep descriptions and tax requirements up to date, ongoing training of customer service personnel, and additional financial reporting and compliance.

If the benefit were significant for the states and municipalities involved, then perhaps this extra cost might be justifiable. The reality is that forcing remote marketers to collect and remit sales and use taxes will add less than 1 percent to the total current tax collections for states and municipalities nationwide.

S. 1832 puts tens of thousands of remote marketing companies at risk of failure. A perusal of the letters ACMA has assembled bears this out as owners and executives document the specific harm the collection of sales and use taxes represents to their businesses.

Remote marketing also supports a large supply chain of "mom & pop" businesses, inventors, artists and artisans, manufacturers, distributors and importers who often lack the scale necessary to distribute via large national retail chains. Moreover, remote marketers necessarily draw on a large variety of vendors and supply chain partners in the creating of catalogs, design of websites, and operation of businesses that would also be adversely affected by S. 1832.

Should S. 1832 be put into law, many smaller catalogers will find it almost impossible to compete as already thin profit margins erode further. Putting an entire sector of the economy and the many jobs they represent at risk for such a small change in tax collections simply is not cost justifiable.

4. Hardship on Consumers

In addition to their positive impact on the national economy, it should be noted that remote marketers play an important role in meeting distinct consumer needs and requirements, needs that are not generally met by large, sophisticated retail chains.

Catalog and Internet sales allow consumers to efficiently select goods that may not be readily available in their local market. They allow convenient shopping for single parent households or dual income families where the adults have precious little free time during typical store hours. They bring a variety of hard to get or unique products to the market that do not have large enough demand to be carried in traditional "brick and mortar" retail store locations. They provide privacy to purchase merchandise that is embarrassing or uncomfortable to purchase in a retail shopping environment. Remote sellers cater to the needs of rural Americans, disabled consumers and older shoppers who may have difficulty driving or walking.

In fact, remote marketing and catalogs specifically bring a wide variety of social, cultural and economic benefits to Americans that are not otherwise available. See ACMA's white paper "*The American Catalog Experience: Catalog Marketing's Social Importance to American Consumers & Culture,*" attached herein as Appendix II. We ask that this be incorporated into the hearing record.

5. Conclusion

The physical presence requirement from the *Quill* law must remain for the collection of sales and use taxes. If that law is to be changed, it must not be done so without significant simplification reform of state sales tax regimes and the establishment of a fair and impartial dispute resolution mechanism. Our national economy is in no position to afford such a burden absent statutorily-mandated simplification and dispute resolution provisions also being included in the law.

ACMA urges Congress to uphold both the current *status quo* of the twice-tested *Quill* precedent as, in fact, fair and equitable, or to take the time to investigate the implications on all remote marketers prior to making any change to the existing laws.

APPENDIX I:

YOUR ID#

CATALOG CODE

186

National®
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LEXINGTON, NC 27294

FOR OFFICE USE

SHIP TO A DIFFERENT ADDRESS
☐ WORK ☐ NEW
☐ GIFT ☐ TEMPORARY
Name
C/O
Address
City State Zip

IF NAME OR ADDRESS IS INCORRECT, PLEASE MAKE CORRECTIONS AT RIGHT.

PLEASE CHECK (✓) METHOD OF PAYMENT:
☐ I am enclosing my check or money order. (Make payable to National Wholesale Co.)
☐ Charge my purchase to my:
☐ Master Card ☐ Discover Card
☐ American Express ☐ VISA
Bank Credit Card No. (Print ALL Digits)
Mo. Yr.
Card Expires
Signature
May we have your phone number in case we have a question concerning your order?
Area Code Phone Number
E-mail address
To help us choose merchandise of greater interest to you, please tell us:
What is your date of birth? MONTH YEAR

ORDER FORM — Shaded area is sample order

	STYLE NO.	QUANTITY	SIZE	•Shoe Width •Bra Cup	COLOR	PRICE	TOTAL PRICE
	#1234	2	34	C	White	$24.95	$49.90
1							
2							
3							
4							
5							
6							
7							
8							
9							

Shipping and Processing
Up to $20.00 ..... $4.95
$20.01 to $40.00 ..... $6.95
$40.01 to $70.00 ..... $8.95
$70.01 to $100.00 ..... $9.95
$100.01 to $150.00 ..... $10.95
$150.01 and over $11.95

AMOUNT OF ORDER
NC Residents Add 6.75% Sales Tax
SHIPPING AND PROCESSING
Rush Delivery add $7.95 to your order (see box below)
TOTAL AMOUNT

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OR FAX 1-732-572-2118

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Check appropriate box, fill in credit information and sign:

☐ Mastercard® ☐ American Express® Card Exp. (Mo/Yr)

☐ Visa® ☐ Discover®

Card Number

Signature

Daytime Phone Number ( )

E-mail Address for Special Offerings:

ITEM NUMBER	COLOR	SIZE	HOW MANY	DESCRIPTION OF ITEM	PRICE EACH	TOTAL
4 1 0 8 1				Easy-Grip Giant Nippers ~~$11.99~~.....$7.99		

Ship to Address (if different from above):

Name

Address

Address

City

State Zip

FREE SHIPPING! On Any Order From This Catalog*

TOTAL MERCHANDISE	
SHOP SMART CLUB Members take 5% discount on merchandise	Subtract:
SHOP SMART CLUB Annual Fee add $9.99	
ADD HANDLING CHARGE	$3.95
SHIPPING PLEASE ADD HEAVYWEIGHT CHARGE(S) IF APPLICABLE*	FREE
PRIORITY SERVICE PLUS PROMPT FREE REPLACEMENT FOR ORDERS LOST IN TRANSIT	$1.95
SUBTOTAL	
ADD SALES TAX (see † left) — NJ, NY, NE, OH RESIDENTS, PLEASE ADD APPLICABLE SALES TAX. (There is no sales tax on clothing and shoes in NJ.)	
TOTAL AMOUNT DUE	

* Certain heavyweight items have an additional charge. See copy block for details.

† For important information re: taxes you may owe directly to your state, please call 1-800-785-0880 or visit www.drleonards.com/salestax.

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Fold

7B-2012

Fold

DO NOT USE STAPLES

TEAR ALONG DOTTED LINE THIS FLAP GUMMED

HAVE YOU ENCLOSED YOUR SIGNED CHECK OR MONEY ORDER? THANK YOU! WE APPRECIATE YOUR ORDER! You must be 18 yrs. or older to order.

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APPENDIX II: THE AMERICAN CATALOG EXPERIENCE: CATALOG MARKETING'S SOCIAL IMPORTANCE TO AMERICAN CONSUMERS & CULTURE

Catalogs Bring *A Variety of Good* to Americans

Overview

The catalog industry has a wide-sweeping impact on American culture, well beyond the economic benefits of employing millions of people, paying millions in federal, state and local taxes, and conserving energy and natural resources. The American catalog experience has significant and important social benefits to American culture and consumers.

Catalogs are Good for American Consumers and Our Quality of Life

- Catalog shopping is convenient and available 24/7/365 from one location accessed by mail, telephone or online. Oil consumption, traffic congestion, and parking are not factors.
- Catalog shopping is unconstrained by geography, thus eliminating physical and distance boundaries. Catalogs put a world of products in the hands of Americans.
- Catalogs allow instant service whenever and wherever people wish to shop. They are accessed anywhere, home or business.
- Catalogs define "universal access" for merchandise and commerce.
- Catalog shoppers consistently report it is easier to get detailed product knowledge and excellent customer service over the phone than elsewhere (or even to find a sales associate). There is usually no or little waiting time to get help.
- Catalogs fight the homogenization of products driven by retail consolidation ("the Wal-Martization of America"). Retail economics force aggressive rationalization of merchandise assortment. If retailers do not sell a high number of pieces per individual store, they cannot exist. If catalogers, who usually offer a much broader assortment, do not sell a high number of pieces nationwide, they cannot exist. Retail and catalog are different business models and both are important for the growth of the American economy.
- Catalogs create an easy way to comparison shop without necessitating multiple trips to different stores.
- Catalogs make sending a birthday, holiday or special occasion present to anyone, anywhere a convenient pleasure, helping Americans stay connected in an increasingly mobile society.
- Catalogs allow people to shop for potentially embarrassing products in the privacy of their own home without worrying about being out in public—for instance, a cancer patient buying a wig, or consumers buying unusual or plus-sized clothing in the privacy of their home rather than in public at stores. Personal hygiene, medical and disability-related products are frequently purchased from catalogs for enhanced privacy.
- Some of the specialty products sold by catalogs includes diabetes-related products, organic products, business productivity tools, pharmaceuticals, and other specialized goods for which a ready retail market might not otherwise exist.
- Catalogs contribute to the quality of life by providing a convenient, fun, compelling leisure time experience. Recreational shopping is an important pastime for many Americans.
- Catalogs remain part of a shared experience in America that remains relevant, human and enjoyable in the increasingly impersonal age of ecommerce and electronic media.
- Catalogs form part of our collective experience. Who doesn't remember the childhood pleasure of paging through the often-remembered Sears Wishbook catalog?

Catalogs are Good for the Environment

- Catalogs may be America's biggest carpool.
- Catalogs have a low carbon footprint and are becoming more environmentally friendly every year. Yes, catalogs use paper, but the modern advances in forestry management have made trees a sustainable crop. In fact, there are more trees in North America today than there were at the time of Columbus's voyage. Plus, advances in the recycling of paper continue to develop and it takes 60 percent less water and energy to make recycled paper than to break lignin into vir-

gin fiber. Please see *www.catalogmailers.org* for more information on Catalogs and the Environment.

- Catalogs make the phone ring, a nearly environmentally neutral communications method in a society increasingly aware about ways to cut our carbon footprint.
- With very few exceptions, catalog companies demonstrate responsible mailing practices, honoring consumer demands concerning mailing frequency, contact methods, and individual consumer needs and wishes. Catalogers are, by the precise and stringent economics of cataloging, self-regulating, and cannot afford to do otherwise.

Catalogs are Good for the Economy

- Catalogs stimulate consumer demand, both for direct and retail, fuelling the largest engine of economic activity we have.
- Catalogs are highly targeted and merchandised to meet specific consumer interests and needs, thus representing an effective and efficient marketing channel to maintain and strengthen American competitiveness.
- Catalog brands have a long-term relationship with Americans that is part of the shared American experience. The ability to come back to trusted brands and companies for the things we need, knowing the consistency and helpfulness we will find as consumers can be relied upon again and again. This is a high ideal of American commerce.
- The robust American catalog shopping experience allows for a shift in power from the retailer to the consumer.
- Catalogs are mailed predominately to willing customers who may have a preexisting relationship with retailers, or to those consumers who have requested a catalog from a company they are interested in shopping with, or to other "opted-in" consumers who have expressed interest in receiving marketing information or specific offers.
- Catalogs help small businesses succeed.

Catalogs Encourage Small Business

- Catalogs allow many small businesses to quickly and efficiently access specialized products that keep them competitive despite their niche focus, small scale or remote location.
- Catalogs efficiently and effectively serve niche avocations and vocations, serving Americans and allowing these businesses to be productive at a lower cost of operations. They help "level the playing field" with larger companies that have more extensive sourcing operations.
- Catalogs provide an important distribution option for small-and medium-sized manufacturers, importers, wholesalers, inventors and designers, all of whom do not have the scale, sophistication or capital to sell their products to the "Big Box" retail giants, which demand prices that are impossible to meet.
- Catalogs provide a national market test for new products and the discovery of small niche market opportunities that would otherwise require large budgets and sophisticated deployment. This creates greater innovation and broader consumer solutions than would be possible otherwise. For example, the electronic thermometer, which is now a standard for families with newborns, was developed in exactly this manner.
- Catalogs provide a national audience for small companies and start-up operations, helping keep small business as the largest creator of jobs in our economy.

Catalogs are Good for Disadvantaged and Rural Americans

- Catalogs can be the only alternative for shut-ins, infirmed, handicapped, elderly or those with limited mobility.
- Catalogs provide viable shopping venues for rural citizens who live too far from stores.
- Catalogs provide the older population with well-being benefits. The regular contact with letter carriers and delivery service providers who deliver packages to the home reduce the sense of isolation and provide beneficial human contact and a "safety-net," helping seniors stay connected to the community and creating a sense of normalcy so critical to well-being and mental health.
- Catalogs enable people to lend a helping hand to those they do not know, including the poor, destitute or imperiled throughout the world (consider, for ex-

ample, Heifer International, CARE, NWF or other nonprofits that have catalog businesses).

- Catalog companies do not have to be located in urban centers and can instead create quality jobs for rural America. High-employment catalog companies are found in locations such as Freeport, Maine; Dodgeville, Wisconsin; Dyersville, Iowa; and many other remote locations.

Catalogs, Their History, and Their Role in American Commerce

- Interstate commerce developed because of catalogs.
- Rural free delivery was spurred on by catalogs.
- Parcel Post developed the required scale due to catalog shipments.
- Early catalog brands were among the first to have a national identity.
- More than half of America shops via catalogs.
- Catalogs allow marketers to have a national footprint without being a mass merchant, having helped develop the idea that we can have national brands without the requirement to open stores in every state.
- Baby Boomers buy more from catalogs—per capita—than any other generation.
- Catalog use increases with the age of the consumer, particularly pertinent in "the graying of America."
- Catalogs provide important content to keep mail relevant and welcome in the household.
- Cataloging did $270 billion in sales in 2006 and supported more than 20,000 different firms, as well as thousands of supplier companies and service vendors.
- Cataloging economics fundamentally changed in 2007 and have spurred industry-wide experimentation to reduce mail volumes, down 35 percent two short years later. That's a figure that will likely continue to grow once catalogers perfect non-mail marketing techniques.

Catalogs and the Internet

- As a whole, catalogers were pioneers in the use of the Internet for the sale of products and services to consumers and businesses.
- By in large, catalogers receive about half their orders online depending on the product category and demographic they serve—yet the paper catalog is responsible for generating more than half a company's online sales (some companies report it is upwards of 90 percent). The symbiotic relationship between the paper catalog and online technology yields greater convenience for everyone from single, working moms to full families, to the elderly, to the physically handicapped, further driving social and environmental benefits, time and efficiency.
- Catalogs are also drivers of retail traffic, promoting commerce, jobs, and convenience for brick and mortar retailers.
- With rare exception, every cataloger has sophisticated e-commerce deployment, making full use of all established and most emerging, technologies.
- Catalogers largely do not distinguish between mail and Internet as business objectives. They see it as being about communicating with people in the way they want to be reached via media consumers already use. It is also about using the most efficient and desirable means possible to stay in touch with customers. The combination of the catalog plus the Internet creates a very powerful marketing and distribution system that impacts and improves lives.
- Catalogs establish brands then extend those brands' reach to the Internet, offering Americans hard-to-find products at value-based pricing.
- Catalogs help consumers feel confident about online purchases. Catalog merchants have a long and protected tradition of honoring their commitments as responsible, customer-oriented, integrity-driven businesses.
- Catalogs prompt people to tell others through social media (*i.e.,* blogs, Twitter and Facebook) about the products that inspire. This "viral" effect of community and commerce has multiplicative financial and emotional benefits. It also increases consumer satisfaction and marketer responsiveness by providing a ready forum for customer comments, reviews and feedback.
- Catalogs provide an alternative transactional method for those Americans concerned about online privacy or transactional safety.
- Catalogs still have the highest order response of any vehicle available to direct marketing. Consumers "vote with their feet." This indicates that a great deal

of value is put on the receipt of a catalog that creates a residual benefit for both online commerce and the American economy.

Conclusion

Since the mid-1990s, many experts have predicted the extinction of the printed catalog. However, until the double-whammy of the huge postage increase of 2007 and the Great Recession of 2008–2009, catalogs in America continued to thrive, aided and enhanced by the maturation of Internet marketing. As both the general economy and postal rates settle down, it will be proven that "rumors of catalogs' demise" continue to be over-stated.

With catalogers' continuously responsive use of recycled paper and tree replanting, as well as their close attention to self-regulation, this responsible industry is primed for greater growth going forward.

PREPARED STATEMENT OF JERRY CERASALE, SENIOR VICE PRESIDENT, GOVERNMENT AFFAIRS, DIRECT MARKETING ASSOCIATION, INC.

I. Introduction

The Direct Marketing Association (DMA) thanks Senators Rockefeller and Hutchinson and the Members of the Committee for this opportunity to present its views on the Marketplace Fairness Act (S. 1832) and the authority of states to require remote sellers to become their tax collectors. There are several bills in Congress that would allow states to conscript non-citizen remote sellers that have no physical presence in the state to become its tax collectors. These efforts are not Federal tax reform—they are not state tax reform. These efforts represent a request from states that Congress impose a 1930s tax regime on 21st Century commerce rather than reforming their tax regimes.

DMA is the leading global trade association of businesses and nonprofit organizations using and supporting direct marketing via channels including mail, telephone, direct TV, radio and the Internet. Founded in 1917, the DMA currently has over 2,000 member companies across the United States and 53 foreign countries.

DMA would like to discuss the history of state efforts to require remote (out-of-state) sellers to become unpaid tax collectors for states, including the Streamlined Sales and Use Tax Agreement (SSUTA).

II. History: Streamlined Sales and Use Tax Agreement (SSUTA)

The U.S. Supreme Court in *Quill Corp.* v. *North Dakota,* 504 U.S. 298 (1992), ruled that without specific authorization from Congress, states could not impose tax collection burdens upon remote sellers that have no "physical presence" as this would interfere with interstate commerce. Moreover, if allowed by Congress, the myriad of state tax jurisdictions with resulting variance in rates, definitions, and audits would create a complex and administratively costly nationwide sales tax collection system. The costs of that collection are a tax on the out-of-state business. It is significant that these remote sellers' businesses do not receive police or fire protection from those states—they are not present in them. Their employees and their families do not receive educational or social services from those states—the businesses have no employees located in those states.

Governments, as well as businesses, face challenging financial decisions in these economic times. State legislatures have very difficult budget determinations and are looking at both cutting costs and increasing revenues. However, proponents of the SSUTA have cited grossly exaggerated revenue estimates of uncollected sales and use taxes due to remote sales. In particular, proponents have cited a 2000 University of Tennessee study that includes unbelievable estimates as to the amount of the uncollected sales tax. A revised Tennessee study lowered its initial estimate from $45 billion to $24 billion—even the revised estimates will not be realized.

It is important to note that the Tennessee study rests on a number of faulty assumptions and is not based on U.S. Government data. Further, the study's implication that states are "losing" a substantial portion of their sales tax revenues to electronic commerce is simply false. The vast majority of e-commerce transactions are not with consumers, but rather with businesses, and such business transactions almost always are subject to tax collection or direct payment of use taxes by the purchaser. Moreover, the marketplace is demanding more rapid delivery of purchased goods. To keep those sales, marketers are establishing more and more distribution centers throughout the country establishing nexus under *Quill* in more and more states. The "lost" tax revenue is shrinking—not growing—due to market demand.

In contrast to the Tennessee study, the independent firm, Forrester Research, has estimated that the loss of tax revenue due to state residents not paying use taxes

for remote sales is $3 billion nationwide—a fraction of the $24 billion estimated in the revised Tennessee study. A 2007 DMA-commissioned study, based on U.S. Commerce Department data, estimates that in 2006 uncollected sales tax nationally totaled $4.2 billion. A 2010 study by Eisenach-Litan found that uncollected taxes in 2008 totaled $3.9 billion. There is no $24 billion pot of gold.

In light of the *Quill* decision, the states began a project to simplify the sales tax regimes that a remote seller would face if required to become the foreign state's tax collector. The SSUTA goal was to remove that complexity and create a 21st century, Internet-friendly tax regime to encourage economic growth throughout the national marketplace. However, the SSUTA has failed to either remove complexity or create that 21st century tax policy standard. To be blunt, the SSUTA is a document drafted by tax administrators, and, as might be expected, it has resulted in little in the way of tax simplification.

Specifically, the SSUTA:

- Has not reduced the number of sales tax jurisdictions in the Nation, which currently number over 9,600;
- Has not reduced the number of state and local sales tax rates;
- Has not reduced the number of audits to which an interstate seller would be subject (each state revenue department would still conduct its own independent audit);
- Has not established a long-promised uniform vendor compensation to cover the substantial cost of tax collection; and
- Has not established a single remittance procedure.

Moreover, the Governing Board of SSUTA has granted exceptions to its feeble simplification initiatives to win approval of the states. Recently, the Board granted an exception from the SSUTA-defined rule for Massachusetts when calculating the sales tax on articles of clothing over $175. SSUTA will continue to grant exceptions that will increase the complexity of sales tax collection. States are enacting sales tax holidays—some for all purchases under a capped price; others for specific products (such as hurricane preparedness) on a specific date. Those actions, while important for the state and its citizens, further complicate a nationwide sales tax collection regime.

As you can see, tax collection has not been simplified since the inception of SSUTA. In fact, SSUTA is "streamlined" in name only.

To better appreciate the failings of the SSUTA, it is instructive to consider its history. The Streamlined Sales Tax Project was launched in 2000 on the heels of two earlier joint government/industry initiatives: the National Tax Association (NTA) Communications and Electronic Commerce Tax Project, and the Congressionally-established Advisory Commission on Electronic Commerce. Both projects had concluded that the existing state sales tax system was one of daunting complexity, and that true simplification would require sweeping reforms.

Perhaps most emblematic of the SSUTA's failure to achieve genuine sales tax reform was the early demise of the single-most important step toward simplification: the adoption of a single sales tax rate per state for all commerce (both over-the-counter sales and interstate sales). Had the SSUTA adopted this so-called "one rate per state" proposal, this single act could have eliminated the problem of merchant compliance with thousands of local tax jurisdictions with different tax rates.

To put this "one rate per state" issue in perspective, the United States is the only economically developed country in the world with a system of sub-state transaction taxes, not only for counties and municipalities, but also for school districts, transportation districts, sanitation districts, sports arena districts, and other local jurisdictions. In light of this wildly complex system, the adoption of the "one rate per state" standard was the *unanimous* recommendation of the NTA's E-Commerce Project (which included delegates of the National Conference of State Legislatures, National Governors Association, and U.S. Conference of Mayors) and was in the majority report recommendation of the Congressional Advisory Commission.

Those failings increase the burden on out-of-state sellers. Being subject to 45 separate state audits requires a tax department. Those businesses would be required to have multiple state registrations and multiple remittance procedures. The cost stemming from tax collection would be passed to consumers, constituting an anti-stimulus at a time when our Nation is working to stimulate the economy. Moreover, remote sellers with locations only in states that do not impose sales taxes, and that, in turn, have no process in place to collect any sales taxes, would be required to create an entirely new tax department within their company and establish entirely new accounting and ordering protocols. Those remote sellers would face even greater burdens.

Any discussion of tax reform concerning non-citizen companies becoming tax collectors for states, should require tax reform in terms of simplification of state sales tax regimes. Only after that reform should Congress consider granting additional interstate taxing authority to the states with the *proviso* that the tax regime simplification must remain in place.

III. The Marketplace Equity Act; The Marketplace Fairness Act; The Main Street Fairness Act

The bills attempt to mitigate the significant burden forced sales and use tax collection places upon non-citizens of a state. Sadly, they fail to reduce the tax burden placed upon remote sellers.

The Marketplace Equity Act grants states three "simplified" alternatives:

- Require collection of a single blended sales tax rate for use in remote commerce; or
- Require collection of the highest sales tax rate in the state exclusive of local tax rates; or
- Require collection of the applicable state and local sales taxes with the state making available adequate computer software to the remote seller and exempting a seller using the software from state liability for incorrect collection.

Experience with the Streamline Sales Tax Agreement indicates that states will choose the latter alternative. States have failed for the past 10 years to reach agreement on single tax rates within a state. With the alternative to require collection for 9,600 tax jurisdictions on the table, that will be the option of choice.

The Main Street Fairness Act grants authority to states that join the SSUTA. It corrects none of the problems with SSUTA discussed above. The bill would grant *carte blanche* authority to a governing board of tax administrators, and as explained above, the governing board has shown no restraint amending its system to become more complicated.

The Marketplace Fairness Act combines elements of the Marketplace Equity and Main Street Fairness Acts. It also would grant *carte blanch* authority to a tax administrator governing board and would grant states not joining the SSUTA authority to conscript non-citizen businesses by simply providing software to the remote vendors.

Even the SSUTA calls for states to provide collection software to remote sellers. This represents a cavalier conclusion that providing software is the answer to the tax burden imposed when states conscript non-citizen remote sellers to become their tax collectors (unpaid collectors under the bills). Tax collection software is not a simple plug-in. Many remote sellers use specialized software for order, fulfillment, billing and inventory control. That software must be up and running 24/7. Adding additional tax collection software cannot cause any down-time for the seller. This adds significant cost to implement any software. Moreover, the tax collection software must be continually updated as states consistently throughout the year tweak their sales tax laws. One Internet based company has testified that the cost to implement sales tax collection in one state cost over $1 million, including work hours. Marketers cannot afford that cost. Thus, the requirement that states make available adequate software does not significantly reduce the burden on interstate commerce notwithstanding what proponents of S. 1832 claim. In addition, each state could make available different software—a true administrative nightmare.

Moreover, the Tax Foundation testified before the House Judiciary Committee on July 24, 2012 that it had purchased tax collection software that was expensive, difficult to use, and found the applicable tax rate but failed to determine what was and was not taxable in the jurisdiction. In addition, the software failed to include tax holidays in its calculations. In essence the software does less than half the job. Technology may well be the solution to this issue, but it is not ready for prime time at the moment.

The bills fail to address the burden of 46 potential audits (45 states and the District of Columbia). Remote sellers would be required to have a tax audit department and legal counsel at the ready for auditors representing 9,600 taxing jurisdictions. Unlike citizen companies, non-citizen remote sellers would be required to go to courts in states where they have no political voice to resolve any disagreements with state auditors over their tax collection. Any bill overturning the physical presence requirement of *Quill* should, at least, repeal the Tax Injunction Act as it applies to disputes on tax collection with non-citizen remote sellers.

The bills fail to address other administrative burdens for non-citizen conscripted tax collectors:

- There is no provision concerning tax holidays that many states have for specific items, such as back-to-school and hurricane preparedness.
- There is no single, uniform rule for sourcing all transactions in a state.
- There is no mechanism to prevent caps and thresholds on taxable items.

The bills should relieve remote sellers from liability of state claims if the seller uses the state "available" software (when that software is perfected and ready for prime time). In addition, remote sellers should be shielded from liability for consumer claims (some coming as class action claims) for errors in sales tax collection when using the state provided software. S. 1832 provides no shield from those claims for remote sellers even when using state "available" software.

The first two alternatives in the Marketplace Equity Act, although DMA believes states will not choose them, create for the first time a different legal sales tax rate for remote sales *vis-à-vis* retail sales. Although today non-citizen remote sellers are not required to collect sales tax, the consumer is liable for that tax—the same tax that is applied to retail sales in the consumer's jurisdiction. This bill would create a different tax rate—some higher than the retail tax rate and some lower. To DMA's knowledge, this is a first—with its own legal considerations.

All three bills assume that the seller calculates the tax for the consumer and includes the tax in the amount charged. DMA has many members whose customers still pay by check and calculate the shipping and would calculate the sales tax themselves. In practice it is impossible for a remote seller to provide the check payer (who likely orders *via* the U.S. Mail) with the tax rates for 9,600 jurisdictions. Moreover, when faced with an incorrectly calculated tax on a check order, the seller faced with an overpayment must either provide a refund or credit and contact the customer with that information and choice which is very costly. With an underpayment of tax the seller is faced with an even more difficult and costly choice. The seller may hold the order and request further payment from the customer or may simple pay the additional tax itself (a new tax burden). DMA knows of a company located in a state with numerous local sales tax rates that simply asks consumers paying by check to remit the state sales tax and it pays the local sales tax to avoid customer confusion. Administrative burden is not washed away by computer software.

None of the bills provide for any compensation for non-citizen remote sellers. The House Judiciary Committee heard from the SSUTA witness that the Agreement does provide for vendor compensation. It does and has for 10 years. However, the governing board of SSUTA has failed for the past 10 years to establish that vendor compensation. Vendor compensation in the SSUTA has become an hollow promise—one in which businesses have no confidence. We have heard the statements made at the July 24th Judiciary Committee before—they are empty and not believable. Passage of any Act, without specific compensation in statute, would eliminate any further discussion on compensation. It is important to remember that these sellers are noncitizens of the state and are being conscripted to become tax collectors for that state. Compensation would be one facet of equity and fairness.

IV. Conclusion

The bright-line physical presence test in *Quill* should remain for collection of sales and use taxes without significant simplification reform of state sales tax regimes. The burden of each on interstate commerce is large, and this is a time when our economy can ill afford such a burden.

DMA urges Congress both to uphold the physical nexus standard of *Quill* rather than extending taxing authority of states to include the collection of sales and use tax beyond their borders without significant simplification reform by the states.

PREPARED STATEMENT OF BILL MCCLELLAN, VICE PRESIDENT, GOVERNMENT AFFAIRS, ELECTRONIC RETAILING ASSOCIATION

Introduction

Chairman Rockefeller, Ranking Member Hutchinson and members of the Committee, the Electronic Retailing Association ("ERA") thanks you for the opportunity to submit this written testimony on the impact of remote sales tax policies for electronic retailers. We believe that the Marketplace Fairness Act, S. 1832, would significantly harm American businesses, their employees and the customers who rely on a healthy and vibrant marketplace. Forcing remote sellers to collect and remit sales tax in jurisdictions in which they do not have physical presence or "nexus" will create a new tax burden resulting in considerable economic harm. It is our view that new and misguided remote tax schemes will materially affect electronic retailers working to survive in these harsh economic times. Massive cost increases and new

regulatory burdens will result damaging consumers and the marketplace on which they rely. ERA urges you to protect electronic retailers, both large and small, from this new tax burden and continue supporting entrepreneurial efforts that create jobs and help stabilize the economy.

The Electronic Retailing Association is the trade association in the U.S. and internationally that represents leaders of the direct-to-consumer marketplace, which includes members that utilize electronic retailing on television and online to engage with consumers. Today, ERA proudly represents more than 450 companies in 45 countries including many of the industry's most prominent retail merchants. ERA's membership consists of a diverse ecosystem of businesses and entrepreneurs operating at the cutting edge of innovation who have adapted to the rapidly evolving challenges found in the current retail landscape.

Background

For decades state governments have wrestled with the challenges of collecting sales and use tax on purchases for out-of-state retailers. What began with mail-order catalogs and telephone orders has increasingly moved online and now state collectors are blaming online commerce for uncollected sales taxes and the decline of Main Street businesses. But the tax loss numbers do not add-up. Main Street retailers use remote selling techniques to compete with mass "brick and mortar" retailers, and upon second glance proposals to simplify tax systems is not so simple and create a new tax burden for affected remote sellers.

The Streamlined Sales Tax Project (SSTP) began in response to the 1992 U.S. Supreme Court decision *Quill Corp.* v. *North Dakota,* 504 U.S. 298 for a catalog business that sold office supplies—long before the modern era of online commerce. This ruling affirmed a 1967 Supreme Court decision *National Bellas Hess* v. *Department of Revenue, 386* U.S. 753 that state sales tax systems are so complex that no retailer—whether storefront, catalog, or online—should have to collect sales tax for states where they have no physical presence or "nexus". The new tax burden of compliance would be too high. That left the states with two options—radically simplify sales tax systems and come back to the Courts for another look, or persuade Congress to force remote retailers to collect sales taxes, whether the systems are simple or not. States pleading for more taxing authority as the first dot-com bubble expanded, and then cried louder as the U.S. economy slowed and spending by states outpaced revenues. State tax officials blamed online commerce for their fiscal problems based on forecasts of growth in e-commerce. A short time later state sales tax revenue had recovered. Despite minimal progress in simplifying sales tax systems again Congress finds itself petitioned to impose new tax burdens on remote sellers as state tax coffers run low.

The Numbers

States, "brick and mortar" retailers and other advocates of the Streamlined Sales Tax Project (SSTP) continue to use estimates that just don't add up. They cite a University of Tennessee study that blames online commerce for $23 billion in lost sales tax revenue a drastic reduction from the study's prior estimate of $45 billion in 2000. An independent review from Forrester Research estimates that unrealized revenue from uncollected sales tax equates to $3 billion nationwide. Similarly, the Direct Marketing Association (DMA) conducted a study in 2006 based upon U.S. Commerce Department data that supports this level finding that the total amount of uncollected sales tax nationwide totaled $4.2 billion. Even if none of that sales tax were collected, the loss would be significantly less than the Tennessee estimates. Despite these findings proponents of SSTP continue to cite questionable estimates from the University of Tennessee study. As Congress debates this issue, it is clearly in the public interest that an accurate portrayal of estimates are provided as members conduct their cost benefit analysis and weigh imposing a new tax burden upon remote sellers.

The Facts

Remote Retailers Collect Sales Tax Today. All online sales already are subject to tax. All retailers whether "brick and mortar" or remote retailer are required to collect sales tax on goods delivered in any state where the retailer has a physical presence or "nexus". Consumers are obligated to pay a "use tax" on all purchases even if the seller is not required to collect the sales tax. States have done little to educate consumers about their use tax obligation or to provide them with any easy way to comply.

New Tax Burdens would harm American Business. Tax collection under this new taxing scheme would cause thousands of American businesses to be confronted with entirely new tax obligations of collecting and remitting taxes for over 9,600 taxing jurisdictions throughout the country. This new tax burden would include school dis-

tricts, transportation districts, sanitation districts and sports arena districts among others. This will dramatically increases the complexity of remote commerce as a viable medium for business activity. State tax collectors have failed in their original mission to reduce the number of tax jurisdictions. Similarly, State tax collectors have failed to reach its goal of uniform definitions for taxable products. Instead, each state is allowed to create its own "gray area" with respect to every term defined in the Agreement. Individual states only have to use "substantially the same language" a recipe for confusion and litigation from businesses forced to comply with this new tax burden. For consumers, the confusion and complexity are even more problematic. Shoppers who pay by check for catalog purchases (a common form of payment among the elderly and low income wage earners) must self-compute the applicable state and local sales tax for each jurisdiction to which a mail order purchase is sent. Again, these are major new tax burdens—not simplification.

The inability of "brick and mortar" big box retailers to compete is overstated. Often "brick and mortar" retailers imply that e-commerce is hurting their business and they cannot compete. Nothing could be further from reality. Despite collecting sales tax for online purchases "brick and mortar" retailers dominate the Internet Retailer Top 500 List of the most successful online retail businesses. The reality is for decades small retailers (online and off) have lost sales to big-box stores. In recent years, the Internet has offered the best hope for success of Main Street retailers to compete.

Efforts to enact online sales tax collection by "big box" retailers represent an attempt to alter the playing field in their favor by unfairly discriminating against remote sellers. Online, burdens are much greater for remote sellers who must compute, collect and remit tax for thousands of jurisdictions, as compared to an in-state retailer who collects at just one tax rate. Remote retailers are also responsible for the difference if a customer fails to remit the correct tax when paying by check—a problem that traditional retailers do not confront. Delivery charges usually exceed the amount of sales tax on those same goods—leaving remote sellers with no price advantage over their "brick and mortar" peers. Competitive claims aside, the evidence clearly show that "brick and mortar" big box retailers enjoy an overwhelming advantage both online and off for the foreseeable future.

Conclusion

The Electronic Retailing Association strongly contests efforts to force a new tax burden upon electronic retailers called for by the Marketplace Fairness Act (S. 1832). Previous Congressional legislation has had significantly more simplification requirements that SSTP states would have to meet. Industry experience with the Streamlined Sales Tax Agreement, dictate that states have not met the minimum standards of true tax simplification or reduce the associated administrative burdens of this new tax burden for remote retailers. At minimum Congress should require robust simplification that ensures a single sales tax rate for each state, requires states to adopt a set of single definitions for taxable and exempt products, reasonably compensates those asked to collect, and provide for adequate liability protection both from state tax collectors as well as from class action lawsuits.

It is also of great concern that software solutions are being championed as a solution to this problem without adequate computer software solutions available in the marketplace. These systems do not currently exist in the marketplace today. Nor can software been seen as a simple fix as all electronic retailers use specialized software for order, fulfillment, billing and inventory control. The chilling effects of software as a "magic" solution cannot be overstated. One Internet based company recently testified that integrating its systems cost $1 million for one state alone. This new tax burden alone would force many members of the Electronic Retailing Association out of business.

Therefore we believe that S. 1832 will devastate electronic retailers working to survive in these harsh economic times. A growing number of industry participants tell us that in recent years they have seen a decrease of up to 40 percent in their sales and that the worst affected are "hanging by a thread." Participants also report being grateful that they have survived the recent economic downturn. Enactment of S. 1832 would call into question their survival with new regulatory requirements and new tax burdens. We urge you to support Electronic Retailers as the industry recovers and resist the urge to hamper budding entrepreneurial efforts to create good jobs that help stabilize the economy.

PREPARED STATEMENT OF ANDREW MOYLAN, VICE PRESIDENT, GOVERNMENT AFFAIRS, NATIONAL TAXPAYERS UNION

Introduction

Chairman Rockefeller, Ranking Member Hutchison, and distinguished Members of the Committee, thank you for the opportunity to submit testimony on behalf of the American Taxpayer regarding the issue of "marketplace fairness" in state sales tax collection. My name is Andrew Moylan and I am Vice President of Government Affairs for the National Taxpayers Union (NTU), a non-partisan citizen group founded in 1969 to work for lower taxes and smaller government at all levels. NTU is America's oldest non-profit grassroots taxpayer organization, with 362,000 members nationwide.

Few citizen groups in Washington can match NTU's 43-year history of principled advocacy on behalf of taxpayers, which is why I hope you will find these comments expressing our serious concerns with S. 1832 (the "Marketplace Fairness Act") and other similar bills helpful in the Committee's vital work. You can also find further research into these topics on our website at *www.ntu.org.*

In short, we believe that such legislation would be profoundly detrimental for taxpayers and remote retailers both large and small because it would dismantle a vital safeguard in the tax policymaking process, create a decidedly "unlevel" playing field, impose enormous compliance burdens on businesses, and harm beneficial economic competition among states by reducing incentives to simplify sales taxes.

Current Law and the Marketplace Fairness Act

Current law prevents tax authorities from forcing a retailer of any type to collect and remit its sales tax unless it has a tangible physical presence in the state. This is a result of the 1992 Supreme Court case, *Quill* v. *North Dakota,* where a Delaware-incorporated office supplier with no presence in North Dakota was found to not be obligated to collect and remit on the latter state's behalf. The Court held that extraordinary sales tax complexity rendered the interstate commerce burden of mandatory collection on out-of-state businesses too great to be constitutionally permissible.

Though states cannot compel non-resident businesses to collect and remit their sales tax, customers are still required to pay "use tax" in lieu of conventional sales tax on an item. The use tax regime, however, is largely ineffectual because it requires self-reporting of which most taxpayers are simply unaware and is difficult to enforce. As a result, states (and competitors to remote retailers) have been clamoring for the Federal Government to override established protections by ordaining a dramatic expansion of their tax authority.

S. 1832 would change current law by allowing states to enforce tax collection and remittance obligations on businesses regardless of physical presence. This would give states licenses to effectively substitute new sales tax requirements on businesses in the place of their current use tax systems. The end result would be more sweeping tax powers, huge new compliance burdens for businesses, and millions (or billions) of new dollars flowing out of the pockets of taxpayers and into the hands of state and local governments, many of which have failed to control their spendthrift proclivities.

S. 1832 Dismantles Vital Taxpayer Safeguard

Contrary to the claims of many Marketplace Fairness Act proponents, current law is not a "loophole" that was implemented as some sort of deliberate attempt to advantage Internet retailers in the World Wide Web's infancy. Instead, the Court's decision drew on and emphasized a bedrock foundational principle of tax policy: the physical presence standard. Simply stated, this standard generally prevents tax entities from extending their authority beyond their physical borders. As a result, businesses and taxpayers alike are shielded from predatory tax administration ploys that might seek to target non-residents for revenue.

The physical presence standard is a strong protection from overzealous tax collection tactics and a fundamental safeguard in American tax policy that is broadly applied as the appropriate boundary which states must observe when asserting tax prerogatives. Physical presence is a constraint on tax collectors that exists in many other areas of tax policy, including business earnings and individual income taxes.

As but one example of the wide-ranging relevance and respect given to the physical presence standard, in May of this year the House unanimously passed H.R 1864, the "Mobile Workforce State Income Tax Simplification Act." This critical legislation, which NTU strongly supported, prevents states from requiring income tax filing or withholding from workers unless they reside in the state or work there for more than 30 days in a calendar year. This common sense criterion will prohibit

unfair income tax filing requirements on non-residents and it has at its core the wise counsel of the physical presence standard.

What the Marketplace Fairness Act would do is erase the physical presence standard for the purposes of remote retail sales (but of course maintain it for brick-and-mortar sales). The result, as outlined further in this testimony, would be an abandonment of the limits on taxing powers that have served our Federal system so well for decades—even centuries—on end.

In fact, S. 1832's language makes very clear the slippery slope to extinction on which it would place the physical presence standard. Section 5(b) of the bill reads like an admission that the legislation could have grave implications for taxpayers: "No obligation imposed by virtue of the authority granted by this Act shall be considered in determining whether a seller or any other person has a nexus with any State for any tax purpose other than sales and use taxes." In other words, the bill's authors are attempting to promise that its language strips away the physical presence protection only for sales taxes and not with individual or business income levies, for example.

This is about as comforting to taxpayers as the claims from its inception that the income tax would apply single-digit rates to only the wealthiest of filers. True, the Sixteenth Amendment and subsequent Revenue Act of 1913 didn't expand the tax to its current levels right away, but it blew the levee protecting ordinary taxpayers wide open and subjected them to a century of ever-creeping taxation. The Marketplace Fairness Act would similarly dismantle one of the few strong taxpayer protections left: the physical presence standard.

Marketplace Fairness Act Would Yield Distinctly "Unlevel" Playing Field

Proponents of S. 1832 argue that their bill is intended to "level the playing field" between brick-and-mortar and remote retailers, but in reality it would do the exact opposite. While the legislation would require remote sellers to collect sales tax on every item, it would force them to do so by a completely different and unequivocally harsher set of rules than exist for brick-and-mortar sales.

If the Marketplace Fairness Act were to pass, states could strong-arm remote sellers into complying with more than 9,600 separate sales tax jurisdictions across the country, each of which can issue its own unique set of edicts and definitions. The reason is that S. 1832 would concoct a "destination-based" sourcing regime which compels a business to collect sales tax based not on its own physical location, but on the location of its customer. An online business would, in turn, have no choice but to quiz each and every customer on their residence, look up the appropriate rate for their locality, and then remit what is collected to a distant tax agency.

Meanwhile, when a brick-and-mortar retailer makes a sale in one of its stores, it doesn't have to jump through any of those hoops. When a customer checks out at a register, they are not interrogated about their residence and then charged the prevailing rate in that locality. This is because brick-and-mortar retailers effectively operate on an "origin-based" sourcing rule, one that collects tax based upon the actual location of the business rather than the consumer. Even states that technically operate their tax regimes under destination-based sourcing rules for traditional retail sales tend to short-circuit them: they attempt to mimic origin-based sourcing by simply assuming that the "point of delivery" of an item is not where its customer lives but where it gets handed back to the customer at the cash register.

This clever bit of maneuvering allows brick-and-mortar retailers across the country to operate on a system whose compliance, at least as far as tax laws are concerned, can be relatively straightforward. Each business determines the prevailing sales tax where it is located and charges that to all of its customers, regardless of their eventual destinations. The Marketplace Fairness Act would deny that administrative convenience to remote retailers by pressing them into a cross-examination process for each and every customer—in the end, decreeing submission to thousands of different sales tax codes.

S. 1832 Imposes Tremendous Compliance and Interstate Commerce Burdens

Because they would now answer to 9,600 tax jurisdictions across the country, remote retailers would have to shoulder heavy overhead costs just to meet their new tax collection liabilities. In fact, the Marketplace Fairness Act essentially acknowledges its imposition of major expenses and complexity by including an exemption for businesses that have remote sales of $500,000 or less per year. The very existence of this provision makes it clear that even sponsors and supporters feel compliance would exact an unbearable toll upon small sellers.

Unfortunately, S. 1832's paltry exemption level (the Small Business Administration threshold for defining a small business is $30 million in sales, while the Mar-

ketplace Fairness Act's exemption is only $500,000) would do little to ease the suffering of smaller businesses, which would be afflicted with even greater competitive disadvantages compared to larger ones as a result of the bill's passage. A 2006 PricewaterhouseCoopers study provides some instructive, eye-opening guidance in this regard. Based on their findings, businesses with between $1 million and $10 million in sales would face compliance costs nearly 2.5 times those endured by larger firms (above $10 million in sales). The smaller the business, the bigger a share of its sales siphoned off just to navigate the maze of our extremely complicated sales taxes.

Some businesses would collapse under the weight of these compliance loads, and others would have to raise their prices substantially in order to make ends meet. As a result, the Marketplace Fairness Act would raise serious impediments to interstate commerce due to its misguided approach toward this issue. Congress has the duty and authority to prevent states from enacting policies that significantly harm interstate commerce, and yet paradoxically S. 1832 would encourage such damage at an especially fragile time for our economy.

Tax Simplification Efforts Have Largely Failed

Much of the movement behind the Marketplace Fairness Act is justified by notions of simplifying sales tax codes across the country. While the Streamlined Sales Tax Project (SSTP) and other efforts have expended much energy on this worthy task, the sad fact is that state sales taxes today are more complex than ever. The number of tax jurisdictions has steadily risen in the 12 years since SSTP's inception and our Nation is nowhere close to the sort of uniformity and ease of administration the project sought to create.

For a glimpse into the reality of sales tax complexity, consider the dilemma of determining when ice cream is a baked good for Wisconsin's tax purposes. Forbes.com writer Josh Barro recently discussed a bulletin from the Wisconsin Department of Revenue seeking to clarify the tax treatment of ice cream cake.

> "The memo goes through ten different examples of cake sales, of which seven are taxable and three are not. Here's an excerpt:
>
> > Example 4—Same as Example 1, except that Restaurant A does not make the ice cream cake. However, after purchasing the ice cream cake from its supplier, Restaurant A decorates the ice cream cake according to instructions received from its customer. It adds designs and words made from frosting and edible gels. Since the retailer mixed or combined two or more foods or food ingredients (*i.e.,* the ice cream cake and the frosting and edible gels) for sale as a single item, the ice cream cake sold by the retailer is 'prepared food' and subject to Wisconsin sales or use tax.
>
> The key issue here is that "prepared foods" are taxable, but foods that are simply bought and resold are generally not prepared foods, and baked goods are not "prepared" even if you bake them yourself, though they may be prepared if you *don't* bake them but *do* decorate them.
>
> If I understand the memo correctly, the rules are as follows. Ice cream cake is a taxable prepared food if you make it yourself, but not if you're just reselling the cake. However, if the cake contains real cake layers, it's a non-taxable baked good no matter who made it, so long as the amount of cake exceeds the amount of ice cream. (No, really: Example 9 is a cake with two cake layers and one ice cream layer, which is tax exempt; Example 10 is a cake with one cake layer and two ice cream layers, which is taxable because it doesn't contain enough cake.) If you buy a cake from someone and then decorate it yourself, it's taxable no matter how much flour it contains. And if you slice any cake and serve it in individual servings, or if the cake consists of fewer than four servings, or if the customer is going to eat the cake on the premises at your business, or if you give the customer utensils with his cake, it's a taxable prepared food, though you may be exempt from that last one if the sale of prepared foods is incidental to your business."

This is a vivid illustration of the true challenge of tax complexity: how a given item is defined. For instance, is a granola bar candy or food? Different states have different answers, each of which may yield different tax obligations. Marketplace Fairness Act proponents claim that there are modern software solutions to address the difficulties of compliance, but that is like saying that TurboTax has solved our mind-numbingly complex Federal income tax code. The computing power to do the basic math involved has existed for decades, but software alone simply cannot solve the ice cream cake conundrum.

Conclusion

The debate over S. 1832 and similar forms of legislation boils down to differences in business models and how governments ought to respond to them. When big-box retail began to threaten true "Main Street," "Mom and Pop" businesses, neither Federal nor state officials took substantial action to "level the playing field" between the two beyond treating them fairly before the law. Nobody suggested legislation to grant Main Street businesses the same deals with suppliers that higher-volume big-box stores could negotiate. No one insisted on a law evening out potential price differences because ultimately competition is beneficial for consumers.

Now Internet retail is beginning to provide a counterweight to brick-and-mortar retail of all types. Even still, only about $7 of every $100 in retail spending occurs online. The Internet will undoubtedly continue to grow, but it has a long way to go before truly threatening the dominance of local retail. Indeed, for all the supposed dangers that the "e-fairness" lobby conjures up in support of its position, there are benefits that have flowed to "Main Street" retailers from the advent of the Internet, including online consulting services, streamlined inventory management, and the ease of "B2B" transactions at the wholesale level. Ultimately, however, the online model of utilizing a smaller physical footprint and relying on technology to reach customers is much like any other throughout the history of commerce: it has advantages and disadvantages that are judged in the marketplace—which is precisely why brick-and-mortar retailers aren't rushing to close down their physical storefront infrastructure.

This competition between business strategies will likewise benefit consumers in the long run. Instead of attempting to equalize outcomes by imposing upon remote sales (and not brick-and-mortar sales) an onerous tax-compliance structure, governments should endeavor to protect taxpayers and treat all businesses fairly by maintaining the physical presence standard of taxation.

S. 1832, the Marketplace Fairness Act, is detrimental to the interests of taxpayers, businesses, and sound tax policy. There are other ways, like uniform origin-based sourcing, to address this matter without trampling on vital pro-taxpayer checks and balances, and without foisting unworkable schemes on remote sellers as well as interstate commerce. Simply treating remote sales in the same way that we already treat brick-and-mortar sales today and devoting any additional revenue to tax rate reductions could level the playing field in an honest way without burying taxpayers in the process.

Over the past year NTU has extensively examined the origin-based sourcing concept and would look forward to constructive discussions with Committee staff to explore further legislative options. In the meantime, NTU urges you to oppose this bill and any other variants that rely on the same destructive destination-based sourcing approach. Thank you for the opportunity to submit this testimony to the Committee today and we would be honored to work with you on this highly consequential issue in the future.

STATE OF WASHINGTON—OFFICE OF THE GOVERNOR
Olympia, WA, October 26, 2011

Hon. PATTY MURRAY, Co-Chair,
Joint Select Committee on Deficit Reduction,
Washington, DC.

Dear Senator Murray,

As you and I have discussed, with the ongoing uncertainties of the national and global economies and with consumer confidence as low as it is, Washington State faces severe reductions in our sales tax collections, resulting in the special session that I called for beginning on November 28.

The task before the Legislature and me is to find $2 billion, out of $8.7B, in reductions in the remaining 18 months of the 2011–2013 operating budget that, unfortunately, will disproportionately hit the very people and programs you and I have fought so hard for in our public careers. The $2 billion in cuts can only be taken out of a total of $8.7B because two-thirds of our remaining budget is protected by state and Federal constitutional and statutory requirements. The impacts to children, veterans, the working poor, and others who most need a hand, and to our educational system, will be far reaching. To the degree that the Joint Select Committee on Deficit Reduction takes up tax issues, I urge you to focus on those issues that help states—not hurt them—and to that end, I offer some recommendations below, and include more specific information on the recommendations (see enclosure).

One key tax matter that would be of tremendous benefit to the state is adopting language to address *Quill* v. *North Dakota* and give states remote collection authority for sales tax from sellers that are not physically present in a state. In July, Senator Durbin introduced the Main Street Fairness Act to give states this authority; and since then, he has continued working with Senators Alexander and Enzi on similar, compromise legislation to gamer the support of a majority of Congress. There is bipartisan gubernatorial support for the Durbin bill through the National Governors Association, and given drafts of the Alexander-Enzi-Durbin proposal that have been shared with states, there will continue to be bipartisan gubernatorial support. Based on the Main Street Fairness Act, Washington State could see tax collections in 2011–2013 estimated at $170.3 million and of $483 million for the 2013–2015 biennium—a tremendous help in the current biennium and in the out years. The state Department of Revenue is working on estimates based on the Alexander-Enzi-Durbin draft.

While the Main Street Fairness Act would be positive for the State of Washington, there are other tax issues that I ask you and your Committee members to strongly resist—issues that would severely limit or eliminate state taxing authorities. Specifically, these issues include the Business Activity Tax Simplification Act (BATSA) and the Digital Goods and Services Tax Fairness Act. The state Department of Revenue estimates state and local revenue losses from BATSA would be $302 million for the 2011–2013 biennium and $1.3 billion for the 2013–2015 biennium. Given the economic climate we find ourselves, preemption of state laws that would result in such losses of revenue is unthinkable.

Thanks again for your consideration of these tax issues in your work on the Joint Select Committee. If you have any questions or concerns, please let me know. And, as always, Mark Rupp in my Washington, DC office is also available to help and reachable at (202) 624–3691.

Sincerely,

CHRISTINE O. GREGOIRE,
Governor.

Enclosure

Recommend enactment the Federal Main Street Fairness Act (MSFA) ***or the alternative measure being developed by Senators Alexander, Enzi and Durbin:*** Currently, state sales taxing authority is limited by the Supreme Court holding in *Quill* v. *North Dakota.* This holding prohibits states from imposing sales or use tax on a seller unless that seller has a physical presence in the taxing state. The MSFA would eliminate this physical presence limitation for those states that have significantly reduced the burden on interstate commerce by simplifying their sales taxes consistent with the Streamlined Sales and Use Tax Agreement (SSUTA). The *Quill* decision noted, "Congress is now free to decide whether, when, and to what extent the States may burden interstate [commerce] . . . [.]" *Quill Corp.* v. *North Dakota, 504 U.S. 298 (1992).* This is Congress's opportunity to accept the Court's invitation. The MSFA embodies sound tax policy, and the Committee should consider and recommend enactment of this bill. The bill:

- *Requires no Federal spending and no tax increase.* The MSFA is a win-win proposition from a fiscal perspective. It would provide state and local governments tax revenue in a time of declining Federal assistance and yet require no actual Federal spending. Moreover, this bill creates no new tax, but rather closes a loophole limiting collection of sales tax from certain sellers.
- *Provides needed tax revenues to the states.* After adjusting for compliance factors and the small seller exception, and vendor compensation pieces of the MSFA, Washington estimates the bill would generate state and local tax revenues of:

  $170.3 million for the 2011–2013 biennium;
  $483. million for the 2013–2015 biennium; and
  $640.9 million for the 2015–2017 biennium.

  The Department of Revenue is working on revenue estimates for the AlexanderEnzi-Durbin compromise bill.
- *Strikes a fair compromise.* The MSFA strikes a fair compromise, providing concessions to minimize the burdens on commerce in exchange *for state* sales tax collection authority. First, the states must reduce the burden on commerce by simplifying their sales taxes through uniform definitions, sourcing provisions, and administrative practices. Second, the bill excludes small sellers, for whom tax collection may be unreasonable or impractical. Third, retailers must receive compensation under the bill in exchange for the new state taxing authority.

- *Promotes local job creation.* Currently, retailers physically present in a state must collect sales tax, while retailers without physical presence need not. This places in-state retailers at a competitive disadvantage and fails to distribute tax burdens evenly among all the sellers that consume state services. The MSFA addresses these inequities, which would help in-state retailers to continue to thrive and serve as an engine for job creation in communities across the country.
- *Is broadly supported.* The MSFA enjoys broad support, including the National Conference of State Legislators, the National Governors Association, the Federation of Tax Administrators, and over twenty SSUTA member states. The MSFA is also supported by representatives from the business community.

Decline consideration of Federal preemptions that impair states' ability to govern effectively: Proponents may ask the Committee to consider Federal preemptions of state taxing authority as a deregulatory stimulus. The Committee should not consider any preemption that significantly impairs the states' ability to raise the revenue needed to govern effectively. Two proposed preemption bills stand out in this regard as outlined below. Some proponents argue that these items should be combined with the MSFA in some manner. The states uniformly oppose such combinations as they will outweigh the benefits to be gained through the MSFA and are unwarranted preemptions of state authority.

- *The Business Activity Tax Simplification Act (BATSA).* This bill purports to create a standard for determining when a seller can be required to pay income and other business activities taxes to a state. The bill would impose a broader physical presence ("nexus") standard than that which currently exists for sales taxes and one that businesses could use as a shield to avoid state taxes that they currently pay. Washington estimates state and local revenue losses from the BATSA would be:

  $302 million for the 2011–2013 biennium;
  $1.3 billion for the 2013–2015 biennium; and
  $2.25 billion for the 2015–2017 biennium.

  Losses of this magnitude would simply devastate state and local governments and impair their ability to govern effectively. If there is a need for a Federal nexus solution, there are other options with fewer negative impacts available.
- *The Digital Goods and Services Tax Fairness Act ("DGSTFA").* The DGSTFA is a bill purporting to promote neutrality, simplicity, and fairness in the taxation of digital goods and services. The DGSTFA suffers from many deficiencies that would contribute to tax avoidance. Without significant amendment and absent a grant of collection authority over sellers that receive the benefits of the DGSTFA, this bill would be a vehicle for tax avoidance and hurt the states' ability to effectively raise tax revenue now and in the years to come. The bill would also give the Federal Government unprecedented authority over the administration of state taxes through concurrent Federal jurisdiction and its related costs. Washington preliminarily estimates state revenue losses from the DGSTFA to be $140 million per biennium. This figure is likely to rise significantly as the economy advances into the digital age and more transactions are covered.

BILL HASLAM
Nashville, TN, November 8, 2011

Senator LAMAR ALEXANDER,
United States Senate,
Washington, DC.

Dear Senator Alexander,

I am writing to thank you for your leadership in helping to advance a Federal solution to a problem states need Congress to address: the preservation of their own right to enforce their own tax laws and returning fairness to the marketplace.

The Marketplace Fairness Act will bring much needed and long overdue relief to the State of Tennessee. Tennessee and other states are currently unable to compel out-of-state businesses to collect sales taxes the same way local businesses do. It is important for states to determine their own tax policy and have the ability to collect the revenues they are already owed. This is why your legislation is so important.

The Internet has changed the way we do business and provides small businesses the opportunity to grow, but we need our laws to adapt to this new marketplace. Our state relies on sales taxes for the majority of its revenue, and each year we are losing hundreds of millions of dollars that could be used to benefit Tennessee. What cannot happen is for Congress to do nothing, which will prevent states from enforcing their own laws.

Your legislation gives states the flexibility to determine what works best for them, and I am grateful that you are putting states' rights first and closing this online sales-tax loophole. The Marketplace Fairness Act strikes the right balance for Tennessee, and I fully support your efforts.

Warmest regards,

BILL HASLAM.

STATE OF MARYLAND—OFFICE OF THE GOVERNOR
Annapolis, MD, December 21, 2011

Hon. BARBARA MIKULSKI
Hon. BENJAMIN L. CARDIN
Hon. ANDY HARRIS
Hon. C. A. "DUTCH" RUPPERSBERGER
Hon. JOHN SARBANES
Hon. DONNA EDWARDS
Hon. STENY H. HOYER
Hon. ROSCOE G. BARTLETT
Hon. ELIJAH E. CUMMINGS
Hon. CHRIS VAN HOLLEN

Dear Members of the Maryland Congressional Delegation:

I strongly urge your support for the Marketplace Fairness Act, and similar proposals that provide a mechanism for states to simplify their sales tax systems and instill parity for in-state businesses—whether they conduct their transactions in person or online. This important legislation, that has bipartisan support among Governors and members of Congress alike, could help ease the burden on state budgets while imposing no new taxes.

As you are well aware, Maryland loses millions of dollars every year in uncollected revenues on purchases made online by Maryland consumers. Additionally, the current situation puts our instate businesses, which make valuable investments in Maryland through jobs and economic activity, at a competitive disadvantage with their remote and online competitors.

In fact, a recent study indicates that the lack of Federal action on this issue will result in Maryland losing $173 million in sales and use revenues this year, a figure that continues to grow as more and more transactions are conducted over the internet. Recouping this lost revenue will help us make investments that continue moving Maryland forward and address the priorities of our people.

Thank you for your consideration and continued hard work on behalf of Maryland families and businesses. Please call on us if we can be of any assistance.

Sincerely,

MARTIN O'MALLEY,
Governor.

STATE OF INDIANA—OFFICE OF THE GOVERNOR
Indianapolis, IN, March 7, 2012

Hon. DAN COATS,
Washington, DC.

Dear Senator Coats:

Please consider joining those who are supporting legislation enabling states to enforce full collection of their sales taxes by remote vendors, generally Internet and catalogue retailers. These taxes are already owed but, in most cases, are being unknowingly evaded by the citizens who should be paying them.

In Indiana's case, the best independent analyses place the uncollected revenue at $70–120 million per year. While this is less than one per cent of total revenue, it is still a material amount in a difficult economy facing uncertain growth prospects. Moreover, there is a serious fairness issue involved, as those retailers now collecting the sales tax are placed at a competitive disadvantage.

I hope you will cosponsor and advocate for S. 1832, The Marketplace Fairness Act, in the interest of both marketplace equity and the continued fiscal soundness of our state.

Sincerely,

MITCHELL E. DANIELS, JR.,
Governor.

STATE OF MAINE—OFFICE OF THE GOVERNOR
Augusta, ME, 12 March 2012

Hon. OLYMPIA SNOWE,
United States Senate,
Washington, DC.

Hon. SUSAN COLLINS,
United States Senate,
Washington, DC.

Dear Senator Snowe and Senator Collins:

I would like to respectfully call on you both to lend your strong support to the Marketplace Fairness Act.

Maine's economy is in transition. Although we still want to attract large manufacturers, we also need to recognize that our economy is increasingly reliant on small businesses and start-ups. That includes a healthy concentration of retail businesses. They are the backbone of our economy and our communities. That is why I believe this piece of legislation *has* particular merit for the people of Maine.

From my experience in the retail world, I can assure you that Maine retailers love competition. They know competition sharpens their services and products, and keeps customers coming back. But the rules need to be fair and applied equally. Give Maine people a chance to compete on a level playing field and they will shine.

Unfortunately, a damaging inequity exists in the retail marketplace because some online retailers are not required to collect Maine sales tax, but Maine retailers are. Not only does this hurt Maine businesses, it hurts the State. If the handcuffs on these small retailers were removed, they could compete on equal terms. They would generate more sales, pay more sales tax to the state treasury, hire more local retailers, and pump more money into local economies throughout Maine.

As you know, the Marketplace Fairness Act does not raise taxes. It simply provides for the collection of sales tax already due. State budget deliberations are well under way, and it would be quite helpful to have certainty about our future revenue streams. I have pledged to lower Maine income taxes and stop wasteful government spending. One powerful tool in achieving these goals would be to have the ability to collect taxes that are due.

There's no denying that passing the bill would give thousands of small Maine businesses a real boost. Through no fault of their own, Federal policy now gives some out-of-state corporations an unfair advantage over other Maine retailers. Our citizens have been patient as Congress tended to the needs of Wall Street. Having studied this bill, I feel that it is now time for Congress to tend to the needs of Main Street. I urge you to vote in favor of the Marketplace Fairness Act.

Sincerely,

PAUL R. LEPAGE,
Governor.

STATE OF ALABAMA—OFFICE OF THE GOVERNOR
Montgomery, AL, April 19, 2012

Hon. RICHARD C. SHELBY
Hon. JEFF SESSIONS
Hon. JO BONNER
Hon. MARTHA ROBY
Hon. MIKE D. ROGERS
Hon. ROBERT B. ADERHOLT
Hon. MO BROOKS
Hon. SPENCER BACHUS
Hon. TERRI SEWELL

Dear Members of the Alabama Congressional Delegation:

As we discussed during our visit in Washington a few weeks ago, an important issue is before the U.S. Congress relating to the collection of online sales taxes and leveling the playing field for our Main Street Alabama merchants. Senators Mike Enzi, Lamar Alexander, and Richard Durbin have introduced S. 1832, the Marketplace Fairness Act, and Representatives Steve Womack and Jackie Speier have introduced H.R. 3179, the Marketplace Equity Act. I commend the members of the Alabama Delegation who have already expressed your support for these bills, and I urge the rest of the Alabama Delegation to cosponsor the legislation or support it when it comes up for a vote.

As you know, I promised to oppose any tax increase on Alabama families, and my support of these bills is consistent with that promise. The bills will not create a new tax, nor will they require states to raise taxes. Rather, the bills will give Alabama the authority to collect sales taxes—as we currently do from local brick-and-mortar retailers—that are already owed from online retailers. The bills will make it easier for businesses to comply with the law and will provide a special exemption for small businesses. Allowing us to effectively close this sales tax loophole would help both our state's finances and our state's small businesses.

Passage of the Marketplace Fairness Act and the Marketplace Equity Act would allow states to bring equity to our sales tax laws. Whether they operate online or in a local retail establishment, any business that sells to a resident of our state should collect and remit Alabama's sales tax. Doing so relieves the consumer of the burden of having to calculate and remit the owed tax, and levels the playing field for all retailers. Current law, which only applies to retailers with a physical presence in the state, gives Internet stores a significant competitive advantage, taking away business from our local retailers and reducing state tax revenue. As more commerce shifts online, our sales tax base is further eroded, which is unsustainable over the long term.

When local retailers lose business, jobs are threatened, communities that depend on the businesses suffer, and our state's economy pays the price. The time has come for Congress to close this loophole by providing Alabama with the necessary tools to update our laws to conform to the reality of today's marketplace.

Given the state's tough fiscal situation, there has never been a better time to enact the Marketplace Fairness Act and the Marketplace Equity Act. E-fairness legislation has been endorsed by the National Governors Association, the U.S. Conference of Mayors, the Alabama Retail Association, and many other groups and individuals throughout the country. I hope we will have your support for this much-needed legislation.

Sincerely,

ROBERT J. BENTLEY,
Governor.

STATE OF MICHIGAN—EXECUTIVE OFFICE
Lansing, MI, May 9, 2012

Hon. HARRY REID,
Office of Senate Majority Leader,
United States Senate,
Washington, DC.

Hon. MITCH MCCONNELL,
Office of Senate Minority Leader,
United States Senate,
Washington, DC.

Dear Majority Leader Reid and Minority Leader McConnell:

I am writing in support of S. 1832, the *Marketplace Fairness Act* and to express my hope for its passage in 2012. As I continue to look for fair and responsible solutions that support economic growth in Michigan, I encourage the Senate to level the playing field for all retailers by establishing a simple, streamlined Federal approach for states to consistently enforce sales and use tax laws.

I support the *Marketplace Fairness Act* because it would enable states to collect sales taxes evenly and fairly across the retail spectrum. "Brick-and-mortar" retailers

throughout the state are currently required to collect sales taxes at the point of sale. By enabling remote sellers to ignore the collection of sales and use taxes, it provides them an unfair competitive advantage and threatens the viability of retailers throughout our communities, many of which are locally-owned small businesses that reflect the unique character and culture of the Great Lakes State.

Technology currently exists to quickly and effectively calculate taxes due on sales and can easily be integrated into online retailers' operations. It is time for Congress to grant states the authority to enforce sales tax and use laws on all retailers doing business in their state.

In fact, the Michigan Department of Treasury estimates that total revenue lost to e-commerce and mail order purchases will amount to $872 million during Fiscal Years 2012 and 2013. As we continue to work to improve the quality and efficiency of services throughout the state, it is crucial that the state has the tools to fairly collect the revenue that it is owed. The *Marketplace Fairness Act* would provide states with the authority to do just that.

Once again, I encourage the Senate to implement a fair and reasonable solution to address this issue. I look forward to working with you as we continue to strive for policies that support fiscal responsibility and fair competition in the marketplace.

Sincerely,

RICK SNYDER,
Governor.

CC: Senator Michael Enzi
Senator Lamar Alexander
Senator Roy Blunt
Senator Dick Durbin
Senator Tim Johnson
Senator Mark Pryor
Senator Jack Reed
Senator Sheldon Whitehouse
Senator Carl Levin
Senator Debbie Stabenow

STATE OF IOWA—OFFICE OF THE GOVERNOR
Des Moines, IA, June 7, 2012

Hon. CHARLES GRASSLEY,
U.S. Senator,
Washington, DC.

Hon. TOM HARKIN,
U.S. Senator,
Washington, DC.

Dear Senator Grassley and Senator Harkin:

I am writing to encourage passage of S. 1832, the *Marketplace Fairness Act.* I understand that the coalition supporting this legislation is now very broad which gives me hope that, under your leadership, this legislation can be passed yet this year. S. 1832 provides an opportunity for Federal leaders to enact an equitable solution that allows for a predictable, simple, and streamlined approach for Iowa and other states to consistently enforce sales tax laws. I join governors of both parties and a bipartisan group of U.S. Senators in support of this legislation. Simply put, S. 1832 allows for Main Street Iowa businesses to be treated more fairly, recognizes the states' rights to enforce their own tax laws and provides a solution to a long-standing issue and tax loophole.

The Marketplace Fairness Act would level the playing field and fairly apply sales tax laws across every type of retailer. There has been an inconsistent application of sales tax laws since the *Quill* v. *North Dakota* case in 1992. Since then, the distortion of the marketplace has only compounded with the growth of Internet sales. The Internet is now a robust, mature, and dynamic marketplace that does not warrant special protections. The application of sales taxes only to "brick-and-mortar" retailers, many of which are small businesses, puts those very entities at a competitive disadvantage.

When this issue first arose in the 1990s, there were legitimate concerns about technological capabilities to calculate sales taxes for online retailers, but through technological advancements, those concerns are no longer applicable. Quite simply, technology exists to enforce sales tax laws without over-burdening online retailers with significant sales. The legislation also includes an important exemption for businesses that do not exceed $500,000 in remote sales. In addition, *Amazon,* which initially opposed solutions like S. 1832, now supports this legislative fix, because it

would allow for a predictable path forward that reflects the realities of the current marketplace.

I know that you welcome opportunities to embrace solutions that enact equitable policies and attract a broad and bipartisan coalition of supporters. The *Marketplace Fairness Act* is one such opportunity and I hope the U.S. Congress seizes it in 2012.

Since returning to the Governor's Office, I have proposed property tax relief for all classes of property and a reduction to our highest in the Nation corporate income tax rate. Both of those proposals are part of a comprehensive and long-term approach to equitable tax policy that supports job creation and increasing family incomes. I believe passage of S. 1832 will level the playing field for Iowa businesses and lessens the tax compliance burden for all citizens. Passage of S. 1832 will be a positive step by the Federal Government recognizing states' rights to control their own fiscal destinies and restoring fairness for Main Street businesses.

Thank you for your time and consideration.

Sincerely,

TERRY E. BRANSTAD,
Governor of Iowa.

cc: U.S. Senate Majority Leader Harry Reid
U.S. Senate Minority Leader Mitch McConnell
Iowa Members of the U.S. House

STATE OF SOUTH DAKOTA
Pierre, SD, June 26, 2012

Hon. MIKE ENZI,
United State Senate,
Washington, DC.

Hon. LAMAR ALEXANDER,
United States Senate,
Washington, DC.

Dear Senator Enzi and Senator Alexander:

I am writing to thank you for the introduction of S. 1832, the Market Place Fairness Act and offer my support for its timely passage. South Dakota has been a longtime leader in the Streamlined Sales Tax project and has worked diligently to make our laws simplified and uniform in order to seek Congressional Authority to require remote sellers to collect tax in South Dakota and other states.

The passage of this bill by Congress will remove a competitive disadvantage faced by main street businesses which are now required to collect tax and help enable South Dakota to continue to provide the services our citizens need and require.

In 2011, e-commerce in the United States totaled $194.3 billion, up 16.1 percent from 2010, according to an estimate released by the United States Commerce Department (source Internet Retailer 2/16/2012). It is very clear that e-commerce will continue to take a bigger portion of overall U.S. retail sales. In fact, South Dakota estimates that total revenue lost to e-commerce this past year was $58 million. That may seem like a small amount compared to other states, but it has a large impact on our budget.

In the early days of online sales, technology did not exist to allow for easy collection of taxes in every part of the country. But today technology has been developed to quickly and effectively calculate taxes due on sales and can easily be integrated into online retailer's operations.

With your help, we can make great strides to ensure equitable collection and payment of sales taxes. This legislation is crucial for allowing South Dakota's main street businesses to remain viable and competitive in difficult economic times.

I encourage the Senate to implement a fair and reasonable solution to address this issue by passing the Market Place Fairness Act. I look forward to working with you to support fiscal responsibility and fair competition in the marketplace.

Sincerely,

DENNIS DAUGAARD,
Governor.

cc: Senator Tim Johnson
Senator John Thune
Representative Kristi Noem

COMMONWEALTH OF KENTUCKY—OFFICE OF THE GOVERNOR
Frankfort, KY, July 19, 2012

Hon. MITCH MCCONNELL,
United States Senate,
Washington, DC.

Dear Senator McConnell:

Since I took office over four years ago, 11 budget reductions totaling over $1.3 billion have been enacted to handle the national recession. Although we are seeing some modest growth in General Fund revenues, Kentucky, like many other states, continues to face difficult budget decisions.

Our most recent budget includes a focus on improving collection of existing taxes through implementation of a tax amnesty program in Fiscal Year 2013. In addition, our plan calls for increased collection efforts after the amnesty period to improve taxpayer fairness by ensuring that all taxpayers are held to the same standard of compliance.

We strongly believe in tax fairness, and your assistance is needed to resolve the inequity. Because of a 1992 U.S. Supreme court decision *(Quill* v. *North Dakota*), states are prohibited from requiring remote sellers, those retail businesses that do not have a physical presence within the state, to collect the sales tax on goods they sell to customers within the state. The Court cited the variation and complexity of sales tax laws and regulations in the various states in its ruling but specifically noted that Congress has the authority to enact Federal legislation authorizing mandatory collection of sales taxes by all retailers.

I write you to request your support for Federal legislation that will give Kentucky and other states the authority to close the sales tax loophole on online and catalog sales. Three bills to fix the problem have been introduced in Congress—the Main Street Fairness Act, the Marketplace Fairness Act and the Marketplace Equity Act. While each takes a slightly different approach, they all would allow Kentucky to require sales tax collection by remote sellers just as we require of our Main Street retailers.

Currently, remote sellers have a significant advantage when they compete with retailers with stores in Kentucky. They are not required to either collect state sales taxes on the goods they sell to Kentuckians or to incur the expense of collection that Kentucky businesses must bear. The playing field must be leveled if we want businesses located in Kentucky to stay in business, These are the businesses that pay property taxes; that provide jobs for our citizens and that are part of our communities throughout the Commonwealth. To put them in the position of serving as a showroom for out-of-state retailers who use the six percent-plus advantage they enjoy by not collecting Kentucky's sales tax to market their products Is simply not fair.

Beyond that, sales tax revenue Is a key component of Kentucky's General Fund receipts. In FY 2011, sales and use tax receipts totaled almost $2.9 billion of Kentucky's nearly $8.8 billion total General Fund revenues. Requiring collection of the sales tax by all retailers would enhance collection of the taxes due and Is estimated to increase Kentucky's sales and use tax revenues by approximately $200 million each year. That amount would certainly help to provide the resources we need to move Kentucky forward so I hope you will support Federal legislation to resolve the problems created by the *Quill* decision.

Please contact my office if you have further questions.

Sincerely,

STEVEN L. BESHEAR,
Governor.

PREPARED STATEMENT OF DAVID FRENCH, SENIOR VICE PRESIDENT, GOVERNMENT RELATIONS, NATIONAL RETAIL FEDERATION

As the world's largest retail trade association and the voice of retail worldwide, NRF represents retailers of all types and sizes, including chain restaurants and industry partners, from the United States and more than 45 countries abroad. Retailers operate more than 3.6 million U.S. establishments that support one in four U.S. jobs—42 million working Americans. Contributing $2.5 trillion to annual GDP, retail is a daily barometer for the Nation's economy. NRF's *Retail Means Jobs* campaign emphasizes the economic importance of retail and encourages policymakers to support a *Jobs, Innovation and Consumer Value Agenda* aimed at boosting economic growth and job *creation. www.nrf.com*

Summary of Comments

Members of the National Retail Federation believe that Congress must resolve the issues presented by the *Quill* decision in order to allow for a level playing field among retail competitors. As retailing evolves and Internet sales become a more prominent portion of total retail sales, it is critical that Congress eliminate the sales tax collection discrimination that exists between brick-and-mortar and remote retailers and allow the free market to operate so all retailers can compete on a level playing field.

Brick-and-mortar retailers compete vigorously with each other and with remote retailers for market share. Different retailers have different strategies for going to market, but one feature is beyond a retailer's control: only some competitors are required to collect sales taxes.[1] This disadvantage is not created by the marketplace, but rather it is imposed by the current state of the law following the *Quill* decision, stifling retailers across the country.

In addition to the pricing disadvantage caused by sales tax being included in the cost of the purchase from the brick-and-mortar store, local stores also bear a significant compliance burden for collecting the tax. Compliance costs for small retailers are extremely high, placing them at more of a competitive disadvantage.[2]

Brick-and-mortar retailers are major contributors to the health of local communities and should not be placed at a disadvantage compared to remote sellers that have no local presence. Brick-and-mortar sellers employ people in the community, pay state and local income taxes, as well as property taxes. They sponsor local causes like the Little League, soccer, and Booster Clubs.

Simplification is a key component for reform of the sales tax collection system for both brick-and-mortar sellers and remote sellers who voluntarily collect sales tax. Many members of the NRF voluntarily collect sales tax on remote sales into states where they do not have a physical presence. In many instances, the retailers that voluntarily collect sales tax do so only from states that have adopted the Streamlined Sales and Use Tax Agreement ("SSUTA") because of the Agreement's simplified collection requirements.

Granting states the authority to collect sales tax from remote sellers will add significant resources to state budgets to support essential local services including teachers, police officers, firefighters and ambulance crews. Remote sales include e-commerce, mail order sales, telephone orders, and deliveries made across state lines. By 2012, total e-commerce sales are estimated to reach $4 trillion dollars.[3]

If a state chooses to raise revenue through the imposition of a tax on goods that are consumed in that state, then there must be a means to apply the tax to all such goods without substantial evasion. If there is no way to do that, then the tax burden will rise to unfair levels on consumers that comply with the law. The Marketplace Fairness Act (S. 1832) resolves this issue, providing fairness to both consumers and retailers, and maintaining the sales tax base for the 45 states that rely on a sales tax system.

NRF is encouraged by this Committee's interest in this issue as well as the several legislative proposals that have been introduced this Congress to address sales tax fairness, especially the Marketplace Fairness Act, introduced by Senator Enzi, Senator Durbin, Senator Alexander, and Senator Johnson. NRF supports Congress granting states remote collection authority with simplifications that ensure retailers are not unduly burdened by collecting and remitting sales taxes. Congress needs to pass S. 1832 this year.

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[1] State sales and use taxes are a form of consumption tax and are imposed on the sale or use of goods and some services that are subject to tax. *It is a tax on the consumer* and is imposed where the consumption takes place. So if a state imposes sales and use taxes on certain goods or services all sales or use of those types of goods or services in that state are subject to the tax, regardless of whether the purchase is made in a store in the state or in the home of a resident of the state through their computer or telephone. States require that retailers collect and remit the sales tax on purchases made in states where they have a physical presence, but the consumer is required to remit the use tax on remote purchases that he makes. There is widespread lack of compliance with use tax laws.

[2] The national average annual state and local retail compliance cost in 2003 was 3 percent of sales tax collected for all retailers: 13.47 percent for small retailers, 5.20 percent for medium retailers, and 2.17 percent for large retailers. PricewaterhouseCoopers LLP, *Retail Sales Tax Compliance Costs: A National Estimate Volume One: Main Report,* April 2006. That study defined "small retailers" as having less than $1 million in annual retail sales.

[3] Donald Bruce, William F. Fox, and LeAnn Luna, *State and Local Government Sales Tax Revenue Losses from Electronic Commerce,* University of Tennessee, April 2009, available at *http://cber.utk.edu/ecomm/ecom0409.pdf.*

Background

In 1992, the U.S. Supreme Court ruled in *Quill* v. *North Dakota* that "remote sellers"—a category that includes mail-order, telephone and Internet merchants—cannot be required to collect sales tax from customers in states where the merchant does not have a physical presence or "nexus." The court reasoned that the sales tax system was too complex for a merchant to know what sales tax to charge an out-of-state customer—45 states and 7,600 local jurisdictions collect sales tax, each with its own rates, lists of taxable items and definitions of taxable items. But the justices suggested that sales tax collection could be required if the system were simplified and Congress authorized the collection authority because remote sellers are "purposely availing" themselves to a jurisdiction's authority by engaging in commerce.

In late 1999, in response to the Supreme Court ruling, states and the business community, including NRF, began the Streamlined Sales Tax Project, with an aim toward significant simplification of state sales tax systems. Since then, a baseline multi-state agreement, the SSUTA, which includes common definitions, uniform processes and procedures, and significantly simplified administrative features has been passed by 24 states (21 full member states and 3 associate member states), establishing the necessary groundwork for action by Congress. The 21 full member states with voting rights include: Arkansas, Iowa, Indiana, Georgia, Kansas, Kentucky, Michigan, Minnesota, Nebraska, Nevada, New Jersey, North Carolina, North Dakota, Oklahoma, Rhode Island, South Dakota, Vermont, Washington, West Virginia, Wisconsin and Wyoming. Three associate member states with negotiating authority but delayed voting rights are Ohio, Tennessee and Utah. Delegates from the 24 states administer the SSUTA through the Streamlined Sales Tax Governing Board.

As electronic commerce continues to grow, so will the losses to state and local revenues.[4] In Fiscal Year 2012, it is conservatively estimated that state and local governments stand to lose at least $23.2 billion in uncollected sales and use taxes from remote transactions, with over $11.4 billion uncollected from e-commerce transactions.[5] General sales taxes make up roughly one third of state tax revenue.[6]

The Effect of Simplification on Retailers

Through adoption of the SSUTA, 24 states have already implemented significant simplification of their sales tax laws. This simplification has incentivized collection of sales tax by many remote sellers that currently are not required to collect sales taxes. Many remote sellers recognize that collecting sales taxes may be a more efficient approach to dealing with the realities of their constantly evolving business model. Nonetheless, their good faith effort to collect sales tax would be undermined by collection authority that did not include significant simplification steps.

While NRF believes that a modest small seller exemption for remote sales is appropriate, raising the level too high will only exacerbate the potential for inequity between a small remote retailer that does not have to collect any taxes and a local small retail competitor who must collect sales taxes on the first dollar of sales. Congress should resist the temptation to envision that a small seller exemption is the easy answer to meaningful small business regulatory relief.

Current Sales Tax Fairness Legislation before Congress

The two leading bills introduced this Congress to address the issue of sales tax fairness are the Marketplace Fairness Act and the Marketplace Equity Act.

(1) Marketplace Fairness Act of 2011, S.1832, sponsored by Senators Enzi, Durbin, Alexander and Tim Johnson provides a path for states to collect sales tax that incorporates a combination of either nine simplification steps or adoption of the SSUTA. The Marketplace Fairness Act exempts remote sellers with less than $500,000 in remote U.S. sales, requires a single audit by states and localities within a state, requires a single state tax rate based on the destination of the sale, states must establish certification procedures for software and service providers (to calculate rates), and gives remote sellers liability protection for relying on incorrect information supplied by service providers.

(2) Marketplace Equity Act of 2011, H.R. 3179, sponsored by Representatives Womack and Speier allows states to collect sales taxes from remote sellers if they meet three minimum simplification requirements. These three simplifica-

[4] *Id.*

[5] *Id.*

[6] Lucy Dadayan and Robert B. Ward, *State Revenue Report,* The Nelson A. Rockefeller Institute of Government, Oct. 2011, No. 85, available at *http://www.rockinst.org/pdf/government_finance/state_revenue_report/2011-10-26-SRR_85.pdf.*

tion requirements may be met in an interstate agreement, presumably including the SSUTA. Sellers with less than $1 million in remote U.S. sales or $100,000 in remote sales into a particular state are exempted. The three simplification steps are: (1) a single revenue authority within a state for submission of a return; (2) a single tax base set by the state; and (3) the state must choose a single tax rate from three choices: a blended rate of state and locality rates, the maximum state rate, or the destination rate.

Each bill grants states the authority to require remote sellers to collect sales tax on transactions into their respective state if simplification steps are adopted. The varying simplification requirements include tax base, tax rate, and collection software requirements. We generally prefer the "hybrid" structure of the Marketplace Fairness Act, which will allow states to choose between a state-based solution like the SSUTA or a set of federally mandated minimum simplification steps before gaining collection authority on remote sales.

Conclusion

The National Retail Federation has long supported sales tax fairness legislation, and we are encouraged by the momentum that is building toward a solution. We look forward to working with the Committee on legislation to ensure effective and fair sales tax collection while relieving burdens placed on a growing sector of the economy.

PREPARED STATEMENT OF HAROLD A. SCHAITBERGER, GENERAL PRESIDENT, INTERNATIONAL ASSOCIATION OF FIRE FIGHTERS

Chairman Rockefeller, Ranking Member Hutchison, and all the distinguished Senators on this committee, I would like to thank you for holding this important hearing on how certain online retailers are exempt from state sales tax law. As the General President of the International Association of Fire Fighters (IAFF), I speak today on behalf of the nearly 300,000 men and women who risk their lives to provide fire, rescue and emergency medical services protection to over 85 percent of our nation's population.

Although IAFF members are committed first and foremost to protecting their communities, they are not immune to the fiscal challenges posed by these difficult economic times. As employees of state and local governments, their livelihoods and their ability to respond effectively to the next house fire or the next heart attack is linked to the budget shortfalls facing far too many governmental jurisdictions.

The stark reality is that the Great Recession has decimated state and local government budgets. According to the Center on Budget and Policy Priorities, state and local governments have closed shortfalls amounting to over $530 billion over the last four years. Despite an improving economic outlook, budget shortfalls still persist. Thirty states have either projected shortfalls or have accounted for shortfalls that total $49 billion for FY 2013. Without additional revenue to balance their budgets, state and local governments will be forced to cut back on essential services, possibly leading to layoffs, station closings and brownouts for the fire service. Additional cuts to the fire service will only exacerbate the dire jobs picture for state and local governments. Since 2009, 611,000 public sector jobs have been lost as a result of the Great Recession.

That is why today's hearing is so important. One factor contributing to budget shortfalls both at the state and local level is the dramatic increase of online sales. Many e-retailers are not required to charge sales and use taxes because they do not have a physical presence in the state where the purchase is made. This special tax preference gives e-retailers an unfair competitive advantage over traditional "brick and mortar" businesses, which must charge sales taxes on almost every item sold, from a pack of gum to a new car.

As more consumers have chosen to buy goods and services online, total sales tax receipts for state and local governments have plummeted. A recent University of Tennessee study found that state and local governments are losing $23 billion each year due to e-commerce. In addition, property tax receipts, which help fund municipal fire departments and school districts, have also been affected as more brick and mortar stores go out of business due to the unfair competition from out-of-state e-retailers.

To address this problem, Congress should pass S. 1832, the "Marketplace Fairness Act." This bipartisan legislation would allow local main street retailers to compete more effectively against out-of-state e-retailers, give states the ability to enforce their own sales and use tax laws, relieve consumers of the legal burden to report to state tax departments the sales and use taxes they owe for online purchases, and

help governors and mayors collect taxes already owed, reducing the need to raise new taxes.

Importantly, this bill does not create new taxes or increase existing taxes. Under current law, consumers living in states with a sales tax are required to remit use taxes for online purchases. Compliance with the law is poor, because most consumers are unaware of their tax obligations. The "Marketplace Fairness Act" simply gives states a way to enforce existing sales and use tax laws while eliminating the competitive advantage currently enjoyed by remote retailers at the expense of local businesses. For states without a sales tax, nothing would change. The "Marketplace Fairness Act" does not require a state to adopt a sales tax. That decision will still rest with the citizens of each state.

In addition to bipartisan support in Congress, a large coalition of organizations has formed to urge passage of the "Marketplace Fairness Act." Government representatives such as the National Governors Association and the U.S. Conference of Mayors, business groups such as the National Retail Federation and the International Council of Shopping Centers, Fortune 500 companies such as Amazon and Best Buy, and labor unions all support this important legislation. At a time when business and labor are often at odds, I hope that this committee will take special note of this unique coalition.

In closing, I would like to again thank the distinguished chairman and ranking member for holding this important hearing, and respectfully request that you keep in mind the views of the IAFF. Our members' ability to respond swiftly to any and all threats to our great country hinges on the most fundamental compact between the individual and society; that is, the ability to raise revenue to fund essential government services. In this regard, I urge you to pass S. 1832, the "Marketplace Fairness Act," so states can have the means, if they so choose, to collect unpaid sales taxes on online and remote purchases.

PREPARED STATEMENT OF THE NATIONAL GOVERNORS ASSOCIATION

The nation's governors call on Congress to help states modernize sales tax systems and encourage greater marketplace competition by taking up and passing legislation like S. 1832, the "Marketplace Fairness Act."

The Marketplace Fairness Act, along with similar bills such as the "Marketplace Equity Act" (H.R. 3179) and the "Main Street Fairness Act", (S. 1542 and H.R. 2071), would remove the barrier preventing states from collecting sales taxes in exchange for states simplifying their sales tax laws. For states, this represents the opportunity to collect more than $23 billion in foregone sales taxes incurred by consumers each year, but cannot be collected.

This collection gap was created by decades-old U.S. Supreme Court rulings in *National Bellas Hess* v. *Illinois, 386 U.S. 753 (1967)* and *Quill Corp.* v. *North Dakota, 504 U.S. 298 (1992),* where the Court held that, absent Congressional authorization, no state may require a seller to collect tax on sales into the state if the seller lacks a physical presence in the state. As a result of that barrier, local brick-and-mortar stores required to collect the tax operate at a competitive disadvantage with remote sellers that do not. Local stores find themselves serving as showrooms for the same products sold by Internet and catalog sellers. Prospective customers examine the merchandise locally then buy the product online or through a catalog to avoid paying sales tax.

To address this problem, the National Governors Association (NGA) and the National Conference of State Legislatures initiated the Streamlined Sales and Use Tax Project (Project) in the fall of 1999. The Project, in turn, generated the Streamlined Sales and Use Tax Agreement (SSUTA), a cooperative effort by the business community, states and local governments to simplify sales and use tax collection and administration. The SSUTA reduces costs and administrative burdens on retailers operating in multiple states. In return, those retailers voluntarily collect tax on sales to customers living in states that comply with the SSUTA.

To date, more than 1,700 retailers have volunteered to collect sales tax in Streamlined states and have remitted more than $900 million in sales taxes that would previously have gone uncollected. This amount, however, pales in comparison to what could be collected under a nationwide system authorized by Congress through Federal legislation.

NGA supports congressional efforts to remove the current barrier to the collection of sales tax, help small businesses expand and assist consumers through fair competition.

For states, the legislation would help reverse the erosion of states' sales tax base due to increasing Internet sales. States closed budget gaps of $325 billion from Fis-

cal Years 2009 through 2012 and will continue to face gaps for Fiscal Year 2013. Rather than asking for one-time relief, which the Federal Government cannot afford and states do not seek, S. 1832 provides a common-sense structural solution that will strengthen states' fiscal condition without adding to the Federal debt.

For business, it means that the corner store is on the same footing with the online retailer. In other words, the local sporting goods store that employs our neighbors and sponsors the little league team has the same requirement to collect sales taxes as the online merchant. It also means that corner store can grow its business more easily. Simplified tax requirements and the availability of easy to use technology make doing business easier by reducing risk and creating opportunity.

The legislation also helps consumers. Fair competition means more choice. The success of electronic commerce should not mean the death of Main Street. Instead, our laws should set the stage for all businesses to compete and succeed.

Federal Legislation

NGA calls on Congress to take up the proposals pending before it and move ahead with legislation that will modernize the state sales tax system and bring it into the 21st century. Specifically, NGA recommends that several core elements be part of any bill.

First, Federal legislation must clearly authorize states to require the collection of sales and use taxes on sales of taxable products and services into their jurisdictions by remote sellers. More important, since authorization is tied to meeting certain simplifications, the legislation should recognize the efforts of states that are compliant with the SSUTA by granting them the authority to collect immediately. If an alternate path is offered for non-SSUTA states, the requirements must be clear to avoid litigation when a state makes changes to gain collection authority.

Second, the legislation should include a de minimis or small business exception that exempts qualifying businesses from the collection requirements. While governors have never specified a level for the small business exception, the size of the exception should be sufficient to relieve the smallest businesses from collection responsibility, but small enough to ensure the exception does not swallow the rule. Any exception will preserve a portion of the tax collection gap states are working to close. NGA encourages Congress to set a low small business exception while allowing states to increase the exception as appropriate.

Third, the legislation should not dictate rates or mandate the imposition or elimination of sales taxes. Our Federal system depends on states retaining the responsibility and authority to manage their taxing policies to meet fiscal requirements. Unless states retain flexibility in conforming to any simplification requirements, they cannot properly ensure the efficiency and administration of the resulting tax system.

Fourth, governors strongly oppose any suggestion that sales tax collection authority be combined with limits or restrictions on state taxing authority in other areas. For example, bills such as the Business Activity Tax Simplification Act (H.R. 1439) are antithetical to efforts by states to modernize their tax systems because they seek to revert back to a "physical presence" standard from which state sales taxes are trying to evolve. Federal legislative proposals like H.R. 1439, which would effectively reduce state taxes through Federal legislation, should not be combined with Marketplace Fairness as the "cost-of-doing-business" for modernizing state sales tax systems.

Conclusion

The time has come for Congress to join with states to improve our laws and ensure government is not picking winners and losers in interstate commerce. S. 1832 represents thoughtful structural change that will help bridge the gap between the physical economy of the 20th century and the digital economy of the 21st century. We encourage the Committee to support efforts to pass legislation this year to promote competition and level the playing field for all retailers.

July 24, 2012

Hon. JOHN BOEHNER,
Hon. NANCY PELOSI,
Hon. HARRY REID,
Hon. MITCH MCCONNELL,
United States Congress,
Washington, DC.

Dear Speaker Boehner, Representative Pelosi, Senators Reid and McConnell:

We are writing to request your support for enactment of S. 1832 this summer. S. 1832 is the Marketplace Fairness Act, sponsored by Senators Enzi, Durbin, Alexander, and others.

This legislation will protect the rights of our states to determine state fiscal policies and establish a level playing field for all retailers, both on Main Street and online. This bill will not create a new tax. Nor will it require our states to raise taxes. Rather, it will permit states to require the largest one percent of out of-state sellers to collect an existing tax on sales to in-state buyers. Although buyers already owe this state tax, they rarely even know about it. The Supreme Court has explicitly held that Congress has the authority to grant the states this permission.

The bill will not apply to the smallest 99 percent of sellers online. Only the largest one percent of sellers—those with interstate sales over $500,000 per year—will be affected. These sellers easily can use already-available computing technology and services to comply. If any sellers, even larger sellers, were exempted, fairness to all retailers would diminish. So we ask that you support the exemption in S. 1832.

We believe that the time to act is now and, respectfully, request your support for enactment of S. 1832 as soon as possible,hopefully by August. Please let us know if you need additional information.

Sincerely,

Robert Bentley
Governor of Alabama

Dennis Daugaard
Governor of South Dakota

Paul LePage
Governor of Maine

Tom Corbett
Governor of Pennsylvania

Mitch Daniels
Governor of Indiana

Bill Haslam
Governor of Tennessee

Rick Snyder
Governor of Michigan

PREPARED STATEMENT OF THE FEDERATION OF TAX ADMINISTRATORS

Introduction

The Federation of Tax Administrators (FTA) is an association of the tax agencies in the 50 states, District of Columbia and New York City. FTA has long supported legislation to require remote sellers to collect sales taxes. Granting states the authority to require all sellers to collect sales taxes from all customers will level the playing field for competing businesses, improve compliance with taxes that are already owed, and remove artificial restrictions that inhibit business investment.

Leveling the Playing Field for Sellers

FTA supports the objectives of S. 1832, The Marketplace Fairness Act. The establishment and explosion of the Internet as a marketplace has redefined the world of commerce forever. At one time considered principally an enforcement problem for the states, the disparate tax treatment between remote and local sales, which has existed for many decades, now poses challenges for local "bricks and mortar" and Internet businesses alike. This legislation should not be delayed or encumbered by special preemption legislation.

The Marketplace Fairness Act and related bills respond to the U.S. Supreme Court's decisions in *National Bellas Hess* and *Quill.*[1] These decisions are widely read to exempt sellers from collecting sales tax from customers who are in a state where a seller has no physical presence. These taxes are owed but frequently go un-

[1] *National Bellas Hess, Inc.* v. *Illinois Dep't of Revenue,* 386 U.S. 753 (1967) and *Quill Corp.* v. *North Dakota,* 504 U.S. 298 (1992).

paid, giving the seller in that case an unfair competitive advantage over traditional local retailers.

We have provided technical comments on elements in any legislation that would assure the maximum participation of the states under the Act. The most important of these elements are:

- Authority granted to states that are either members of the Streamlined Sales and Use Tax Agreement (SSUTA) or that choose to conform their laws to Federal statutory standards.
- Ability for states to designate the specific taxes covered by the generic phrase "sales and use taxes."
- Flexibility to recognize exceptions from uniform rate and base requirements that have already been agreed to between states and industry groups under SSUTA.
- Authority for states to continue to impose origin sourcing for intrastate sales or sales by non-remote sellers.
- Recognition that states may have additional ways of lowering burdens on remote sellers and the retention of authority for states to use these approaches as well.
- Preservation of state authority to require sellers to maintain necessary records.
- Exclusion of any mandatory vendor compensation provision, as this requirement would significantly reduce state participation.

FTA believes that legislation that does not have a demonstrable need or share the joint support of businesses and states should not be considered when enacting remote seller sales tax collection legislation. The clearest example of the type of legislation that should not encumber the sales tax legislation is the Digital Goods and Services Tax Fairness Act of 2011 (S. 971). There is no discernible, let alone pressing, need for the legislation because states do not widely subject digital goods or services to taxation (with the long-standing exception of software). Furthermore, discriminating against digital goods and services is already illegal under the Internet Tax Freedom Act (ITFA), which specifically prohibits multiple or discriminatory taxes on electronic commerce. In addition, the states that have closely examined S. 971 believe they would suffer significant revenue losses.

Finally, states have identified numerous technical deficiencies with S. 971, which will create uncertainty, unnecessarily disrupt tax administration, and lead to years of litigation. Until businesses and states can reach a consensus on how to address these technical deficiencies, the Digital goods and Services Tax Fairness Act or any other preemptive legislation like it should not be considered when enacting remote seller sales tax collection legislation.

Again, we thank the Committee for the opportunity to present our views on the important topic of remote seller sales tax collection legislation. We urge Congress to enact legislation like S. 971 this year.

NATIONAL LEAGUE OF CITIES
Washington, DC, July 31, 2012

Hon. JOHN D. ROCKEFELLER IV,
Chairman,
Commerce, Science, and Transportation Committee,
United States Senate,
Washington, DC.

Hon. KAY BAILEY HUTCHISON,
Ranking Member,
Commerce, Science, and Transportation Committee,
United States Senate,
Washington, DC.

Dear Chairman Rockefeller and Senator Hutchison:

On behalf of the 19,000 cities and towns represented by the National League of Cities (NLC), I write to applaud you for holding a hearing on the sales tax fairness issue. Legislation such as the *Market Place Fairness Act* (S. 1832) will assure a simpler system of taxation and help our members recover tax revenues that are due from purchases made by remote means. Importantly, the *Market Place Fairness Act* does not impose a new tax, but would provide states and localities with a mechanism to require the collection of existing sales and use taxes on Internet and mail-order sales. As you know, this is legislation NLC has long supported.

In 1992, the United States Supreme Court ruled in *Quill Corp.* v. *North Dakota,* 504 U.S. 298, that states cannot require retailers to collect sales taxes from purchasers who are not located in the same state as the seller. As a consequence, local

retailers who compete with online companies are at a 6 to 10 percent price disadvantage, and state and local governments are deprived of billions of dollars in revenue. It is significant to note that consumers are already required to pay taxes when they make online purchases, just like when they make purchases in a store; however, most taxpayers are not aware of this responsibility, and states and localities cannot enforce payment.

In its decision, the Court explicitly stated that Congress, with its clear constitutional authority to regulate interstate commerce, can grant states and local governments the option to require sellers who do not have a physical presence in their jurisdiction to charge and collect sales taxes from their customers. The *Market Place Fairness Act* simply provides such authority. This year alone, states and local governments stand to lose an estimated $23.3 billion, according to a University of Tennessee study.

Again, thank you for recognizing the importance of the *Market Place Fairness Act.* As local governments continue to face the fifth straight year of declines in local revenues with further declines projected in 2013 and continuing cutbacks in Federal aid, we ask for passage of this legislation as soon as possible. Our ability to preserve needed infrastructure investments and essential services in our communities rests on it.

Sincerely,

DONALD J. BORUT,
Executive Director.

RETAIL INDUSTRY LEADERS ASSOCIATION
Arington, VA, July 31, 2012

Hon. JOHN D. ROCKEFELLER IV,
Chairman,
Hon. KAY BAILEY HUTCHISON,
Ranking Member,
U.S. Senate Committee on Commerce, Science, and Transportation,

Dear Chairman Rockefeller and Ranking Member Hutchison:

On behalf of the Retail Industry Leaders Association (RILA), we commend the Senate Commerce, Science, and Transportation Committee for holding an informational hearing this week on the issue of e-fairness and S. 1832, the Marketplace Fairness Act, legislation introduced by Senators Mike Enzi, Dick Durbin and Lamar Alexander. The bipartisan Marketplace Fairness Act corrects a critical flaw in our state taxation policies that today puts brick and mortar stores at a competitive disadvantage to online-only companies that aren't required to collect state sales taxes. RILA thanks the Committee for brining greater attention to this issue and urges Congress to enact the Marketplace Equity Act this year.

By way of background, RILA is the trade association of the world's largest and most innovative retail companies. RILA promotes consumer choice and economic freedom through public policy and industry operational excellence. Its members include more than 200 retailers, product manufacturers, and service suppliers, which together account for more than $1.5 trillion in annual sales, millions of American jobs and operate more than 100,000 stores, manufacturing facilities and distribution centers domestically and abroad.

At issue is a decades-old loophole that requires that brick and mortar retailers collect sales taxes if they have a physical presence in a state, while online-only companies aren't held to the same standard. This policy has the effect of putting local brick and mortar stores, who take the time to build a store, hire locally, contribute to the community, and pay property taxes, at a 5–10 percent competitive disadvantage on price. Tax policy that treats two competitors differently is inherently unfair, and the Marketplace Fairness Act pending before Congress takes a reasonable approach toward leveling the playing field while providing protection for small businesses and requiring states to simplify their collection requirements on remote sellers. To be clear, this is not a new tax or a tax on remote sellers; it is simply a question of whether all types of business will collect, on behalf of the consumer, a tax that is already owed.

In closing, RILA appreciates that the Committee is giving the issue of e-fairness and the Marketplace Fairness Act the appropriate attention it deserves. The growing bipartisan support for e-fairness legislation over the past few months has become evident, with governors, editorial boards and businesses all calling on Congress to take action this year. RILA urges Congress to take action on the Marketplace Fairness Act this year so that the government gets out of the business of pick-

ing winners and losers in the marketplace, and so that our members can get back to the business of serving our customers and helping to grow the economy.

Sincerely,

BILL HUGHES,
Senior Vice President,
Government Affairs.

Cc: Members of the Senate Commerce, Science, and Transportation Committee

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Hon. JOHN D, ROCKEFELLER IV,
Chairman,
Committee on Commerce, Science, and Transportation,
United States Senate,
Washington, DC.

Dear Chairman Rockefeller:

Thank you for holding a hearing on the critical issue of the disparity in sales tax collection between brick-and-mortar retailers and online sellers.

As Chairman of the West Virginia Retailers Association and owner of two local jewelry stores in South Charleston and Hurricane, I know firsthand how the inequity in our current sales tax collection structure can affect retailers.

I am proud to make a contribution to the economy of our state. My business provides employment for sixteen West Virginians, does business with local suppliers and vendors wherever possible, and pays taxes that support local government services, Those expenditures ripple throughout the local economy, and we are enthusiastic supporters of community activities in non-economic ways as well.

But Main Street stores like mine that support local jobs are under attack. The reason: big, out-of-state sellers on the Internet don't have to collect sales tax on most of their sales, giving them a significant pricing advantage on top of the benefits of working with high volume, law overhead and outsourced customer "service." For me in West Virginia, that means an out-of-state "e-tailer" can automatically undercut my best price just by virtue of not having to collect our state's six percent sales tax.

This disparity has forced me to cut margins on the merchandise and services I sell just in order to compete with Internet sellers who are able to offer jewelry with no sales tax. I have no problem with competing for customers and business; in fact, I welcome it. I want to compete with other businesses to give consumers the best experience they can get. But I should be competing among all the factors that define healthy competition—customer service, product offerings, and even price—not sales tax. It's an unfair and unequal system that forces me to compete on our current sales tax collection system, which favors an Internet seller over a local retailer.

With this current system, it's not only my local stores that suffer. Lost sales or lost margin d disparity on sales tax collection means less money for employee wages, less money for inves into my store and my community, and fewer taxes that support local government services. online sales tax collection is about more than just fairness among retailers. West Virginia is o many states losing out on more than $23 billion a year nationwide in uncollected sales tax re Those tax dollars are badly needed to pay the salaries of essential government workers like officers, firefighters, ambulance crews and schoolteachers.

Federal legislation like the Marketplace Fairness Act law would finally level the sales tax play allowing all merchants to play under the same rules regardless of whether they sell their me online, through the mail or in a traditional bricks-and-mortar store. l strongly urge you and the Committee to work towards a level playing field for all merchants—local and online.

Sincerely,

DAVID BROYLES,
Chairman,
West Virginia Retailers Association.
Owner,
Calvin Broyles Jewelers.

PREPARED STATEMENT OF JOSEPH HENCHMAN, VICE PRESIDENT, LEGAL & STATE PROJECTS, TAX FOUNDATION

THE PROPER ROLE OF CONGRESS IN STATE TAXATION: ENSURING THE INTERSTATE REACH OF STATE TAXES DOES NOT HARM THE NATIONAL ECONOMY

Mr. Chairman, Mr. Ranking Member, and members of the Committee:

I appreciate the opportunity to submit this statement on Congress's role in the debate over state sales taxation of online purchases. In the 75 years since our founding in 1937, the Tax Foundation has monitored tax policy trends at the Federal and state levels, and our data and research is heavily relied upon by policymakers, the media, and the general public. Our analysis is guided by the idea that taxes should be as simple, neutral, transparent, and stable as possible, and as a 501(c)(3) nonprofit, non-partisan organization, we take no position on any pending legislation.

We hope that the material we provide will be helpful in the Committee's consideration of the issue.

Executive Summary

- After the bitter experience of the Articles of Confederation, the Constitution empowered Congress with the responsibility to rein in state tax overreaching when it threatened to do harm to the national economy.
- Consequently, states were not permitted to tax items in interstate commerce at all, from the Founding until approximately the 1950s.
- Since then, as formally adopted by the U.S. Supreme Court in the *Complete Auto* decision (1977), states may tax interstate commerce so long as the tax is non-discriminatory, fairly apportioned, related to services, and applies only to businesses with substantial presence (nexus).
- In a series of decisions, most recently the *Quill* decision of 1992, the U.S. Supreme Court explained that "substantial nexus" for sales/use tax purposes means physical presence of property or employees. The Court ruled that it exceeds to state powers for them to be able to demand use tax collection from companies that are not physically present in the state.
- States have sought to overrule the *Quill* decision, either legislatively ("Streamlined") or through defiance ("Amazon" tax statutes). The defiance approach in particular has caused significant disruption and uncertainty to the economy.
- Every state with a sales tax also imposes a use tax, levied on taxable items upon which no sales tax has been paid. In other words, use taxes seek to thwart competitive pressure from other states with lower tax rates. Taxpayer compliance with these protectionist use taxes is minimal. (Use tax, with a few exceptions, is imposed on the *consumer* and not the *seller.*)
- Congress has passed a number of statutes limiting the scope of state tax authority on interstate activities ("preemption"), carefully balancing (1) the ability of states to set tax policies in line with their interests and that allow interstate competition for citizens over baskets of taxes and services and (2) limiting state tax power to export tax burdens to non-residents or out-of-state companies, or policies that would excessively harm the free-flow of commerce in the national economy.
- When a resident of a state purchases from a brick-and-mortar retailer, they generally must pay sales tax. When the same resident in the same state purchases the same product from an online retailer, they often do not pay sales tax.
- Many large Internet retailers are expanding the number of states in which they have physical presence, to enable next-day delivery, but that is not the case for many smaller sellers that remain in just one location and use common carriers to deliver purchases.
- There are approximately 9,600 jurisdictions in the United States that collect sales tax, a number that grows by several hundred each year. Subscription tax software is inadequate and can be expensive for occasional sellers, and few states provide adequate tax lookup or consolidated tax filing options. Sales tax can vary by product, by time, and by location in the state. In 7 states, local governments can have a different sales tax base from the state tax base.
- Congress has five basic options on how it may proceed:
  - *Reaffirm the physical presence rule* for sales taxation, and by implication, the disparity of treatment between brick-and-mortar sales and Internet sales.
  - *Reaffirm the physical presence rule* but adopt a new tax approach that mitigates the disparity of treatment between brick-and-mortar sales and Internet

sales (such as an origin-based system or a national sales tax on online purchases).

- *Modify the physical presence rule* in the limited context of state collection of use tax from out-of-state sellers, by those states that have adopted simplified sales tax systems under minimal Federal standards, to reduce the harm to interstate commerce. This trade-off would replace the check on state power provided at present by the physical presence rule.
- *Repeal the physical presence rule* without conditions on the states, granting states unchecked authority to export tax burdens and damage interstate commerce.
- *Do nothing* and risk the continued growth of unchecked and fragmented state authority to export tax burdens and damage interstate commerce.

The Constitution Empowers Congress to Limit State Tax Power When It Seeks to Shift Tax Burdens to Non-Residents or Do Harm the National Economy

What you have before you is not a new issue. Absent congressional or judicial checks, states have an incentive to shift tax burdens from physically present individuals and businesses, to those who are beyond their borders. Indeed, it was the states' unchecked behavior in this regard that led to the Constitutional Convention in the first place. Under the Articles of Confederation, states with ports taxed commerce bound for interior states, tariff wars proliferated, and the national economy was imperiled. As Justice Johnson described in 1824, these actions were "destructive to the harmony of the states, and fatal to their commercial interests abroad. This was the immediate cause that led to the forming of a convention." [1]

And so the Constitution was adopted, and through that document, the Congress was granted the power to restrain states from enacting laws that harm the national economy by discriminating against interstate commerce.[2] James Madison noted that these powers would check the "clamors of impatient avidity for immediate and immoderate gain" that drive state legislation discriminating against non-residents.[3] Justice Story later praised the "wisdom and policy in restraining the states themselves from the exercise of [taxation] injuriously to the interests of each other." [4]

So strong was this concern that the rule for a century and a half was that states could not tax interstate commerce at all.[5] This eroded in the 1950s and 1960s as it was recognized that those engaged in interstate commerce do enjoy benefits in states where they are present, so it is not unfair to have them support those services with taxes. The complete ban on state taxation of interstate commerce was abandoned in 1977, replaced by a recognition that resident businesses engaged in interstate commerce should pay for the fair share of the state services they consume. In *Complete Auto Transit, Inc.* v. *Brady,* the U.S. Supreme Court held that states may tax interstate commerce if the tax meets a four part test: [6]

- *nexus, a sufficient connection between the state and the taxpayer;*
- *fair apportionment, the state cannot tax beyond its fair share of the taxpayer's income;*
- *nondiscrimination, the state must not burden out-of-state taxpayers while exempting in-state taxpayers;*
- *fairly related, the tax must be fairly related to services provided to the taxpayer.*

Before and since *Complete Auto,* the courts have routinely exercised this power to restrain state tax infringements on interstate commerce, and these decisions are one of the more non-controversial aspects of constitutional law. Congress has also been active in this area, legislating limits on state tax power where states are incapable of achieving a simplified, uniform system that restrain each state from claiming more than its fair share of taxes on interstate commerce. These have included prohibiting state taxes on food stamps, Federal Reserve banks, interstate air-

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[1] *See, e.g., Gibbons* v. *Ogden,* 22 U.S. (9 Wheat.) 1, 224 (1824) (Johnson, J., concurring).

[2] *See* U.S. CONST. art. I, § 8, cl. 3 (Interstate Commerce Clause); U.S. CONST. art. I, § 10, cl. 2 (Import-Export Clause); U.S. CONST. art. I, § 10, cl. 3 (Tonnage Clause); U.S. CONST. art. IV, § 2, cl. 1 (Privileges and Immunities Clause); U.S. CONST., amend. XIV, § 1 (Privileges or Immunities Clause).

[3] James Madison, THE FEDERALIST NO. 42 (1788).

[4] 1 STORY CONST § 497.

[5] *See, e.g., Freeman* v. *Hewit,* 329 U.S. 249, 252–53 (1946) ("A State is . . . precluded from taking any action which may fairly be deemed to have the effect of impeding the free flow of trade between States"); *Leloup* v. *Port of Mobile,* 127 U.S. 640, 648 (1888) ("No State has the right to lay a tax on interstate commerce in any form.").

[6] 430 U.S. 274 (1977).

line and bus travel, satellite services, and nonresident members of the military and nonresident members of Congress. Congress has also banned discriminatory state taxes on Federal employees, interstate electricity transmission, and interstate railroads.

Nexus Based on Physical Presence

Generally, the historical standard is that states may tax those physically present in the jurisdiction, and may not tax those not physically present. This is premised on a view known as the "benefit principle": that the taxes you pay should roughly approximate the services you consume. State spending overwhelmingly, if not completely, is meant to benefit the people who live and work in the jurisdiction. Education, health care, roads, police protection, broadband access, etc.: the primary beneficiaries are state residents. The "benefit principle" thus means that residents should be paying taxes where they work and live, and jurisdictions should not tax those who don't work and live there.

A physical presence standard for state taxation is in line with this fundamental view of taxation. Developments have arisen in the three major state tax areas (corporate income tax, individual income tax and sales tax), as well as with some other state taxes (such as telecommunications taxes, taxes on digital goods, car rental taxes, and so forth). Bills have been introduced in the Congress that seek to reaffirm the physical presence rule in these areas (such as BATSA with corporate income tax, Mobile Workforce with individual income tax).

Recent Developments in State Sales Tax: Overview

There are a number of proposals to reverse a series of U.S. Supreme Court decisions (most recently the *Quill* decision of 1992) that prohibit states from imposing sales tax collection obligations on businesses with no property or employee in the state. This "physical presence" standard is meant to prevent states from shifting tax burdens to non-residents away from residents who are the primary beneficiary of state services, while also protecting the free flow of interstate commerce from the compliance costs of non-uniform and numerous (9,600+) sales tax jurisdictions in the United States (see Figure 1, Figure 2, and Table 2).

The steadily increasing growth of Internet-based commerce has however led to frustration with this standard, primarily due to disparate sales tax treatment of similar goods within states that has no economic basis. This can be addressed while also ensuring that some standard exists to restrain states from engaging in destructive behavior, such as tax exporting to non-voters or imposing heavy compliance costs on interstate businesses, that the Congress is empowered to prevent. Further, because economic integration is greater now than it has ever been before, the economic costs of nexus uncertainty are also greater today and can ripple through the economy much more quickly. These actions are only the latest chapter in a long saga over the proper tax treatment of sales made over the Internet, and an even longer saga over the proper scope of state taxing authority. At its core is a dispute over which is more important: limiting state power to tax nonresidents and thus harm the national economy, or ensuring that some transactions do not escape tax because they are conducted online. Discussions following a recent compromise in California, driven by the desire of large Internet retailers to expand their physical presence to enable next-day delivery, suggest that there are policy options that could achieve both ends.

Figure 1: New State/Local Sales Tax Jurisdictions Created Each Year

Figure 2: Sales Tax Jurisdictions with Changes Each Year

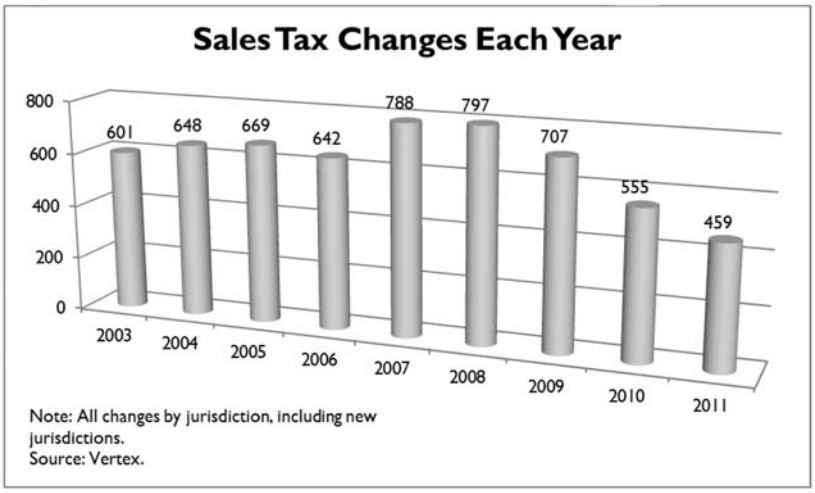

Table 2: Other Examples of Contributors to Sales Tax Complexity

States With Local Option Sales Taxes: **37**
States That Permit Local Government to Define A Separate Sales Tax Base: **7**
States With Sales Tax Holidays: **17**

The *Quill* Decision: Not a Loophole, But a Check on State Power to Export Tax Burdens and Do Harm Interstate Commerce

What is nexus for a remote seller? In 1967, the U.S. Supreme Court held that a business does not have nexus with a state if the business has no retail outlets, solicitors, or property in the state, and communicates with customers only by mail or common carrier as part of a general interstate business.[7] Otherwise, the Court concluded, states could "entangle National's interstate business in a virtual welter of complicated obligations to local jurisdictions with no legitimate claim to impose a fair share of the cost of the local government." This decision was reaffirmed after the *Complete Auto* test was announced in 1977.[8]

During the 1980s, some academics and many states criticized *National Bellas Hess* as archaic, formalistic, and outmoded. Officials were encouraged to ignore the decision, and some state courts disregarded it, even as the number of sales taxes rose from 2,300 to 6,000. Different murky definitions of economic nexus have been proposed:

- Engaged in exploiting the local market on a regular, systematic, large-scale basis.
- Presence of intangible property or affiliates
- Number of customers in state, value of assets or deposits in the state, and receipts attributable to sources in the state
- Analysis of frequency, quantity, and systematic nature of economic contacts with the state
- Derivation of economic benefits from state's residents

Defying the Court rulings, North Dakota enacted a law requiring the out-of-state Quill Corp. to collect sales tax on its sales to 3,000 in-state customers. Any state that advertised three times in the state was liable. In the case, the U.S. Supreme Court reaffirmed *National Bellas Hess* and *Complete Auto.*[9] There they stated that the physical presence rule "firmly establishes the boundaries of legitimate state authority to impose a duty to collect sales and use taxes and reduces litigation concerning those taxes."

The Streamlined Sales Tax Project Has Watered Down Membership Standards in an Unsuccessful Effort to Entice More State Members in Its Effort to Change *Quill*

Today, there are over 9,600 state and local sales tax jurisdictions in the United States. There are different rates on different items, they change frequently, and are not even aligned to 9-digit zip codes. States are reluctant to cooperate on even basic rules and definitions.

The Streamlined Sales Tax Project (SSTP) was launched in 2000 with the mission of getting states to adopt changes to their sales taxes to make them simple and uniform. SSTP then hopes to convince Congress or the courts to overrule *Quill* and allow use tax collection obligations on out-of-state companies ("Main Street Fairness Act").

However, the SSTP has abandoned simplification efforts and any attempt to reduce the number of sales tax jurisdictions, instead focusing on uniformity efforts. In many cases, the Project has enabled state sales tax complexity by permitting separate tax rates for certain goods. States generally are reluctant to yield parochial advantages, even with the possibility of online sales tax revenue in return, undermining their argument to Congress as part of the Main Street Fairness Act that they have succeeded in their mission. Large states have generally avoided the SSTP, and membership has been stuck at ~20 states for some time. This in turn has led to impatience from states and others.

Some States Have Sought to Defy *Quill* through Unconstitutional Legislation

In 2008, New York adopted an "Amazon" tax, nicknamed after the Internet retailer as the most visible target. The law held that a person or business with no physical presence in the state nevertheless has nexus if it (1) enters into agreement with in-state resident involving commissions for referring potential customers; and (2) has gross receipts from sales by out-of-state company from referrals within the state are more than $10,000 in a 12-month period.

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[7] *See National Bellas Hess, Inc.* v. *Dept. of Revenue of Ill.,* 386 U.S. 753, 759–60 (1967).
[8] *See Nat'l Geographic Society* v. *Ca. Bd. Of Equalization,* 430 U.S. 551, 559 (1977).
[9] *See Quill Corp.* v. *North Dakota,* 504 U.S. 298 (1992).

Amazon.com & Overstock.com responded by terminating affiliate programs in New York, and Amazon.com filed a lawsuit in state court. The law was upheld by a trial judge (New York's trial courts are called the "New York Supreme Court," causing confusion about who upheld the Amazon tax as constitutional); the judge concluded that Amazon.com's in-state affiliates are necessary and significant to establishing and maintaining out-of-state company's market in the state. But because they make up only 1.5 percent of sales, that was the basis for the appeal. The New York Supreme Court, Appellate Division ruled in late 2010 that law is not facially unconstitutional but may be unconstitutional for Amazon. The case was remanded to the lower court, but Amazon is appealing to state's highest court, the New York Court of Appeals. The case is ongoing.

In 2009, Rhode Island and North Carolina adopted identical New York-style laws. Neither has seen any revenue and Rhode Island has actually seen revenue loss due to reduced income tax collections from terminated in-state affiliates. Laws were also passed in California and Hawaii but vetoed. (See Table 3 for a status of all state efforts to defy *Quill* legislatively.)

Table 3: Status of State Efforts to Defy *Quill* Legislatively

Arkansas	Enacted mid-2011.
California	Enacted mid-2011 but effective date postponed after agreement reached with state.
Colorado	Enacted 2010. Ruled unconstitutional.
Connecticut	Enacted mid-2011.
Illinois	Enacted 2011. Ruled unconstitutional.
New York	Enacted 2008. In litigation.
North Carolina	Enacted 2009. Ruled unconstitutional.
Rhode Island	Enacted 2009. Officials report that the law has reduced state tax collections. May be repealed.

Source: Tax Foundation compilation. Does not include states where legislation was proposed but not adopted.

In 2010, Colorado considered the same law but faced opposition from in-state affiliates. Instead it adopted a law (H.B. 10–1193) designed to push Amazon into collecting use taxes without explicitly requiring it. In January 2010, a Federal judge stayed the law stayed as probably unconstitutional on First Amendment grounds, and the law was thrown out completely in April 2012.[10] A similar law in North Carolina was also struck down as violating the First Amendment in October 2010.

In 2011, Illinois and Arkansas enacted New York-style laws (the Illinois law was subsequently ruled unconstitutional). California enacted one but after a possible repeal referendum was proposed, the state and Amazon.com reached an agreement whereby Amazon.com will develop a physical presence in the state (*i.e.,* build warehouses).

While for the most part unsuccessful, these state efforts have highlighted the desire to modify the *Quill* holding in some way. This pressure is likely to continue.

Possible Solutions

Substantial progress has been made in recent months toward possible solutions that could (1) simplify sales tax systems and avoid discriminatory compliance costs, (2) eliminate non-neutral tax rates on similar products sold by online and brick-and-mortar businesses, (3) limit taxation in a state to those residents who enjoy the benefits of state services, (4) prevent multiple taxation of interstate commerce, and (5) prevent unconstitutional and fragmented state attempts to impose such tax burdens in a destructive manner.

Congress has five basic options on how it may proceed:

- *Reaffirm the physical presence rule* for sales taxation, and by implication, the disparity of treatment between brick-and-mortar sales and Internet sales.
- *Reaffirm the physical presence rule* but adopt a new tax approach that mitigates the disparity of treatment between brick-and-mortar sales and Internet sales (such as an origin-based system or a national sales tax on online purchases).
- *Modify the physical presence rule* in the limited context of state collection of use tax from out-of-state sellers, by those states that have adopted simplified sales tax systems under minimal Federal standards, to reduce the harm to interstate commerce. This trade-off would replace the check on state power provided at present by the physical presence rule.

[10] *See* Mark Robyn, "Colorado Amazon Regulations Ruled Unconstitutional," (Apr. 4, 2012), *http://www.taxfoundation.org/blog/show/28111.html*

- *Repeal the physical presence rule* without conditions on the states, granting states unchecked authority to export tax burdens and damage interstate commerce.
- *Do nothing* and risk the continued growth of unchecked and fragmented state authority to export tax burdens and damage interstate commerce.

The third option is the basis for several pending pieces of legislation; this would allow the states to collect use tax from remote sellers on condition that they simplify their sales tax systems in accordance with minimum Federal specifications. The Marketplace Equity Act (H.R. 3179) and Marketplace Fairness Act (S. 1832) are two recent proposals that would eliminate the physical presence rule but otherwise make advances towards ensuring that states reduce the burdens associated with collecting their sales taxes. Example provisions include requirements that states have a single state-level agency that administer all sales tax rules, offer one tax return and audit for the entire state, require one uniform tax base for the entire state, provide software that identifies the applicable tax rate for a sale, including local rates and hold sellers harmless for any software errors or mistakes by the state, provide 30 days' notice of any local sales tax rate change, and exempt sellers with a *de minimis* level of collections. (See Table 4 for a comparison.) Effective simplification is a necessity for any Federal proposal.

Table 4: Provisions of Current Pending Federal Legislation

Before Collecting Remote Use Tax, State Must…	Marketplace Equity Act	Marketplace Fairness Act	Main Street Fairness Act
Designate one state entity to collect, process, and audit returns for all tax jurisdictions in the state.	✓	✓	✓
Establish unified audit of remote sellers for all taxing jurisdictions in the state.	×	✓	×
Establish a single tax return for all taxing jurisdictions in the state.	✓	✓	✓
Provide or certify tax collection and remittance software. (**Note**: Not necessarily free software)	✓	✓	✓
Hold remote sellers harmless for errors in state-provided software.	✓	✓	✓
Adopt standardized definitions of commonly taxed goods.	×	×	✓
Offer immunity to remote sellers who misapply sales tax holidays.	×	×	×
Compensate vendors.	×	×	✓
Offer a single statewide blended rate as an option.	✓	×	×
Require local jurisdictions to use the state's sales tax base.	✓	✓	✓
Require local jurisdictions to align geographically with 5-digit zip codes	×	×	×
Legislation explicitly preempts other state efforts to force use tax collection by tax out-of-state sellers.	×	×	×
"Small seller exception"	$1m in U.S., $100k in state	$500k in U.S.	To be set
Legislation establishes federal court jurisdiction for enforcing simplification standards.	×	×	✓

Source: Tax Foundation review of legislation. Main Street Fairness Act review includes only provisions incorporated in federal law, not those merely adopted by its Governing Board.

All these simplifications are desirable, and together would provide a sufficient check on state tax overreaching while leaving ample space for states to structure their tax systems and rates in line with their own preferences. The only infringement on state sovereignty is an infringement on state power to burden interstate commerce with problematic tax policy.

Congress has passed a number of statutes limiting the scope of state tax authority on interstate activities, carefully balancing (1) the ability of states to set tax policies in line with their interests and that allow interstate competition for citizens over baskets of taxes and services and (2) limiting state tax power to export tax burdens to non-residents or out-of-state companies, or policies that would excessively harm the free-flow of commerce in the national economy. A package specifying a floor of

all the simplifications listed in Table 5 would be welcome and would greatly reduce constraints on economic growth.

Conclusion

Businesses throughout our Nation's history have plied their trade across state lines. Today, with new technologies, even the smallest businesses can sell their products and services in all fifty states through the Internet and through the mail. We at the Tax Foundation track the numerous rates, bases, and exemptions that litter our state sales tax codes. Frequent and ambiguous alterations of tax codes and the confusion they cause are a key source of the growing tax compliance burden. We have several staffers as well as computer-based and publication subscriptions dedicated to being up to date and accurate on the frequent changes, but even we have trouble doing it. It would be extremely difficult for those in business to do business, not conduct tax policy research.

We now live in a world of iPods, telecommuting, and Amazon.com. It is a testament to the Framers that their warnings about states' incentives to hinder the national economy remain true today. Some may argue that faster roads and powerful computers mean that states should now be able to tax everything everywhere. While some constitutional principles surely must be revisited to be applied to new circumstances, the idea that parochial state interests should not be permitted to burden interstate commerce remains a timeless principle regardless of how sophisticated technology may become.

About the Tax Foundation

The Tax Foundation is a non-partisan, non-profit research institution founded in 1937 to educate taxpayers on tax policy. Based in Washington, D.C., our economic and policy analysis is guided by the principles of sound tax policy: simplicity, neutrality, transparency, and stability.

About the Center for Legal Reform at the Tax Foundation

The Tax Foundation's Center for Legal Reform educates the legal community and the general public about economics and principled tax policy. Our research efforts focus on the scope of taxing authority, the definition of tax, economic incidence, and taxpayer protections.

THE COUNCIL OF STATE GOVERNMENTS
August 1, 2012

Senator JAY ROCKEFELLER,
Chairman,
Senate Committee on Commerce,
Science, and Transportation,
Washington, DC.

Senator KAY BAILEY HUTCHISON,
Ranking Member,
Senate Committee on Commerce,
Science, and Transportation,
Washington, DC.

Dear Senator Rockefeller and Senator Hutchison:

On behalf of the Council of State Governments (CSG), the Nation's only association serving all three branches of state government, we want to express CSG's support for the Marketplace Fairness Act and commend you for highlighting the importance of tax fairness at your upcoming hearing. This legislation is essential both for establishing a level playing field for America's retail employers and ensuring that states and territories have the legal authority they need to collect revenues that are already owed to them.

Governors and legislators appreciate that our country faces a fiscal crisis. We have first-hand experience in meeting this challenge having collectively addressed over $500 billion in budget gaps since the beginning of this recession.

However, it is this very fiscal challenge that underpins the importance of Congress passing the Marketplace Fairness Act. In an era of decreasing revenues and stark economic challenges, we can't afford to maintain revenue systems which advantage one sector of our retail community over another while depriving our jurisdictions of revenue which could be used to lower tax burdens for all, make needed investments in infrastructure, or pursue any other number of policy options that states and territories are best equipped to identify.

Given the long list of issues currently before the Senate, we thank you both for choosing to draw attention to this important issue. If we can be of assistance to you and your staff as you pursue the impact of this important legislation please do not

hesitate to contact ourselves or CSG's Washington Office Director, Chris Whatley, at (202) 624–5460 or *cwhatley@csg.org*.

Sincerely,

STATE SENATOR JAY EMLER, KANSAS,
CSG Chairman.

GOVERNOR LUIS FORTUÑO, PUERTO RICO
CSG President.

August 1, 2012

Hon. JOHN D. ROCKEFELLER IV,
Senate Commerce, Science,
Transportation Committee.

Hon. KAY BAILEY HUTCHISON,
Senate Commerce, Science,
Transportation Committee.

Dear Chairman John D. Rockefeller and Ranking Member Kay Bailey Hutchison:

Our undersigned labor unions thank you for your leadership in convening the Commerce Committee August 1 hearing, "Marketplace Fairness: Leveling the Playing Field for Small Business", on the bipartisan Enzi Durbin-Alexander "Marketplace Fairness Act" (S. 1832). Our unions strongly support S. 1832 and this hearing is an excellent opportunity to demonstrate its broad and bi-partisan support. We support S. 1832 because it would grant states, which streamline their sales tax systems, the authority needed to collect the sales and use taxes they are owed. As sales increasingly move to the internet, it is vital to highlight the resulting problems and S. 1832's potential benefits.

Our unions have long supported constructive Congressional proposals that enable state and local governments to collect sales and use tax from remote and online sellers of goods and services. University of Tennessee economics professor Dr. William Fox estimates uncollected use tax from all remote sales in 2012 will cost state and local governments a cumulative $23 billion. While the loopholes are always problematic, they are very troubling now because states and localities suffer from years of broadly reduced revenues. In addition, out of state and online sales are skyrocketing along with uncollected sales and use taxes. Together, these loopholes inflict unfair competitive disadvantages on Main Street and mom-and-pop retailers.

Now is the time to enact S. 1832. First, Congress has clear constitutional authority to act to regulate interstate commerce of online and remote sales. Second, state and local governments support S. 1832 and urge Congress to act on this issue. Their ongoing work to develop the Streamlined Sales and Use Tax Agreement demonstrates they could implement effective and efficient solutions. Third, both large and small businesses also support S. 1832 and urge Congress to act. They are supportive because it levels the playing field for all businesses and streamlines sales tax systems. Finally, many experts have demonstrated that small business remote sellers can relatively easily collect sales and use taxes. Accurate, affordable, and user-friendly software now provides automatic computation, compilation, and collection of sales taxes.

We must note that S. 1832 would not enact new taxes. The affected taxes already exist under current law in all45 states (and the District of Columbia), which impose a sales and use tax. Unfortunately, millions of U.S. consumers either unknowingly or purposely do not pay existing use taxes on their remote and online purchases. S. 1832 merely provides states the authority and ability to collect these existing uncollected taxes. It is also important to note that S. 1832 would have no cost to the Federal Government.

We thank your Committee for convening this important hearing and providing Senators Enzi, Durbin, and Alexander with an opportunity to discuss the "Marketplace Fairness Act". We strongly support their bill.

Sincerely,

American Federation of Labor and Congress of lndustrial Organizations (AFL–CIO)

American Federation of State, County and Municipal Employees (AFSCME)

American Federation of Teachers (AFT)

Department for Professional Employees, AFL–CIO (OPE)

International Association of Fire Fighters (IAFF)

International Federation of Professional and Technical Engineers (IFPTE)

National Education Association (NEA)

Service Employees International Union (SEIU)

The International Union, United Automobile, Aerospace and Agricultural Implement Workers of America (UAW)

SOFTWARE FINANCE AND TAX EXECUTIVES COUNCIL
August 1, 2012

Via E-mail

Hon. JOHN D. ROCKEFELLER, IV,
Chairman
Hon. KAY BAILEY HUTCHISON,
Ranking Member,
Committee on Commerce, Science, and Transportation,
United States Senate,
Washington, DC.

RE: HEARING ON S. 1832—THE MARKETPLACE FAIRNESS ACT

Dear Chairman Rockefeller and Ranking Member Hutchison:

I write on behalf of the Software Finance and Tax Executives Council (SoFTEC) to express the views of the software industry on S. 1832, the Marketplace Equity Act. If enacted, this legislation would give states the power to require that out-of-state sellers collect and remit state sales and use taxes owed by consumers who purchases goods and services from such sellers; in essence, a legislative overturn of the Supreme Court's decision in *Quill* v. *North Dakota.* SoFTEC strongly believes that any legislation making such significant changes must also (1) require that a state first adopt "radical simplification" of its sales and use tax laws and (2) resolve uncertainty regarding the appropriate nexus standard for imposition of state income and other business activities on out-of-state businesses. Because S. 1832 lacks such provisions, SoFTEC does not support this legislation in its current form. We ask that you make this letter a part of the record of the hearing on this matter.

SoFTEC is a trade association providing software industry focused public policy advocacy in the areas of tax, finance and accounting. SoFTEC's members sell their products in many states and must maintain an infrastructure that handles the administrative burden associated with collecting and remitting sales and use taxes for those states in which they have physical presence. SoFTEC's members have an interest in this legislation because enactment of it would expand the number of states for which they must collect and remit sales taxes and would require significant investment to expand their infrastructure devoted to sales and use tax compliance. Enactment of the bill also could lead to an inference that the physical presence nexus standard has been repealed not only for sales and use taxes but for state income and other business activity taxes as well, significantly increasing their exposure to such taxes.

Radical Simplification

One reason SoFTEC does not support the bill is that it would not require that states radically simplify their sales and use tax systems as a prerequisite to the grant of collection and remittance authority. In deciding the physical presence nexus standard was appropriate to protect remote sellers from the burdens of administering myriad state and local sales and use taxes, the Supreme Court in *Quill* pointed to the Nation's 7,800 plus taxing jurisdictions at the time. *Quill* was decided in 1992 and the number of taxing jurisdictions has grown to 9,600 in the meantime. In short, since *Quill* was decided, the burden has grown significantly with a nearly increase in the number of taxing jurisdictions.

The bill does nothing to reduce the number of tax jurisdictions for which remote sellers would have to collect and remit sales and use taxes. The bill, instead, seeks to address this problem by mandating that states furnish "adequate" software that would identify the applicable rate. This seems to suggest a "one-size-fits-all" software solution to the problem. But there are states and the District of Columbia and there is no suggestion that they all provide the same or similar software. Nor is there any requirement that the states provide versions of the software compatible with the myriad computer-based billing systems used by remote sellers. We alsonote that such software is expensive to integrate into existing systems and maintain. Requiring that states provide software as a prerequisite to obtaining collection authority is not a solution to the problem.

We believe mandating a single rate per state for remote sales is the solution to the problem. In a single stroke, such a mandate would reduce from 9,600 to 46 the number of state and local taxing jurisdictions a remote seller would be faced with. States could use their internal political processes to resolve differences with local jurisdictions with regard to setting the rate and distributing collected taxes to the individual localities. Coupled with the single form and filing and uniform state tax base components of the bill, this approach would cause much of the existing complexity to recede into the background. One-rate-per-state for remote sales represents the main ingredient in the sort of "radical simplification" needed to justify repealing

the physical presence nexus standard for sales and use taxes of the *Quill* decision. But, even more simplification should be required before expanded collection authority is granted.

Alternative to Streamlined Sales and Use Tax Agreement

The bill allows two paths to collection authority. First, states that are members of the Streamlined Sales and Use Tax Agreement will obtain collection authority roughly three months after the bill is enacted. Other states that adopt a modicum of sales and use tax simplification must wait six months after their legislatures adopt the simplification package. We are concerned that the simplification adopted by the Streamlined states is more rigorous than the other non-members states would have to adopt in order to obtain the same expanded collection authority. We are concerned the availability of this easier path to collection authority will serve as a disincentive for those states to join the Streamlined Agreement and could provide an incentive for current Streamlined states to drop out of the Agreement.

The easier path to collection authority should be dropped from the bill and collection authority should be conferred only upon states that are, or later become, members of the Streamlined Agreement, provided additional simplification requirements added to the bill. Specifically:

- Collection authority should be withheld for states that have not adopted the one-rate-per-state proposal suggested above,
- Destination sourcing for all remote sales should be another condition for collection authority.
- Federal court jurisdiction should be expanded to include cases or controversies involving the Streamlined Agreement (see below).

Federal Court Jurisdiction

SoFTEC also does not support the bill because it would not permit Federal courts the power to interpret and enforce state compliance with the Federal requirements for expanded collection authority. The processes and remedies available at the state level are inadequate, expensive, time consuming and biased. Additionally, the interpretation and enforcement of the Streamlined Agreement by its own Governing Board makes the administrators of the Agreement also the judges and the jury. Having Federal courts interpret and administer the requirements for expanded collection authority would foster both fairness and trust in the system.

Physical Presence Nexus for State Income and other Business Activity Taxes

Disputes between states and businesses over the appropriate nexus standard for imposing state taxes on out-of-state businesses are not limited to sales and use taxes. Many states point to the fact the *Quill* case only involved sales and use taxes as a reason for using a different nexus standard for other types of state taxes, such as income and other taxes based on business activity. The business community, on the other hand, believes the Commerce Clause of the Constitution does not impose different nexus standards depending on the type of tax involved and the physical presence nexus standard of *Quill* applies to all types of taxes. It would be inappropriate to eliminate the physical presence nexus requirement for sales and use taxes but leave unresolved the existing uncertainty regarding its application to other types of taxes.

In October of 2011, the House Judiciary Committee reported H.R. 1439, the Business Activity Tax Simplification Act of 2011 (BATSA). This bill would resolve the uncertainty regarding the appropriate nexus standard for state income and other business activity taxes by codifying the physical presence standard of *Quill* for those types of taxes. SoFTEC supports BATSA and believes Congress should pass it before (or at the same time as) it passes any legislation impacting the physical presence nexus standard for sales and use taxes.

Conclusion

For the reasons stated above, SoFTEC does not support S. 1832, The Marketplace Fairness Act, in its current form. We thank you for the opportunity to provide these comments. Any questions regarding them should be directed to Mark E. Nebergall who can be reached at (202) 486–3725 or *mnebergall@softwarefinance.org.*

Respectfully submitted,

MARK E. NEBERGALL,
President,
Software Finance & Tax Executives Council.

CC: Senator Michael B. Enzi

PREPARED STATEMENT OF SENATOR PAMELA ALTHOFF, ILLINOIS; DELEGATE SHEILA HIXSON, MARYLAND; AND SENATOR CURT BRAMBLE, UTAH; EXECUTIVE COMMITTEE TASK FORCE ON STATE AND LOCAL TAXATION, NATIONAL CONFERENCE OF STATE LEGISLATURES

Chairman Rockefeller, Ranking Member Hutchinson and members of the Commerce Committee, we are pleased to submit this statement on behalf of the National Conference of State Legislatures and respectfully request that you submit it for the record. The National Conference of State Legislatures is the bipartisan national organization representing every state legislator from all fifty states and our Nation's commonwealths, territories, possessions and the District of Columbia.

We are pleased to have the opportunity to inform you of the concerns of state legislators about state and local taxation in the new economy, specifically, the ability of state and local governments to collect the sales and use tax presently owed on transactions with remote sellers, which occur primarily through electronic commerce. We want to express our full support for the Marketplace Fairness Act, S. 1832 as introduced by Senators Mike Enzi of Wyoming, Richard Durbin of Illinois, Lamar Alexander of Tennessee and 17 other of your colleagues from both parties. The Marketplace Fairness Act will provide those states that comply with the simplification requirements outlined in the legislation, the authority to require remote sellers to collect those states' sales taxes.

Let us make this very clear, state legislators are not advocating any new or discriminatory taxes on electronic commerce. We desire, however, to establish a simplified sales and use tax collection system that allows sellers regardless of where they are located to collect and remit the legally owed sales and use taxes.

The new economy or if you prefer, electronic commerce, which is not bound by state and local borders makes it critical to simplify the collection state and local taxes to ensure a level playing field for all sellers, to enhance economic development, and to avoid discrimination based upon how a sale may be transacted. Government can not allow a tax system that was designed for an economy that existed almost 80 years ago, to be the deciding factor as to where our constituents make a transaction.

As many of you may know, state legislators and governors have been seeking the ability to collect sales taxes on out of state transactions for many years. With the growth of electronic commerce, the current financial and economic situation, and the effort to address the Federal deficit, the urgency to act is even more immediate.

As you know, the recent recession has had a debilitating impact on state budgets. According to NCSL's survey of state legislative fiscal officers, between FY 2008–FY 2013, states closed a cumulative $527.7 billion budget gap, primarily through program reductions. While some states have showed a slight increase in revenues, other states are still facing budget deficits and sluggish revenues. For FY 2012, states have closed over $72 billion in state budget deficits.

With the enactment of the Federal Budget Control Act and the resulting sequestration, states are preparing for additional reductions to many state Federal programs. The likely $400–$500 billion in reductions in Federal funds as a result of deficit reduction coupled with the over $500 billion in state budget reductions during the recession will mean that states have $1 trillion less for many essential programs than states had only five years ago. Raising taxes in sluggish economy is not a viable option for most states, and closing the loophole on sales tax collection will provide states with additional revenue without having to raise new taxes.

According to the Center for Business and Economic Research at the University of Tennessee, in 2003, the estimated combined state and local revenue loss due to remote sales was between $15.5 billion and $16.1 billion. For electronic commerce sales alone, the estimated revenue loss was between $8.2 billion and $8.5 billion. The report from the University of Tennessee further estimates that the revenue loss will grow and that this year, 2012, the revenue loss for state and local governments could be as high as $23 billion, of which it is estimated that $11.4 billion would be from sales over the Internet. (See Table 1)

Table 1.—Combined State & Local Revenue Losses from E-Commerce and All Remote Commerce—2012

Source: Dr. Donald Bruce & Dr. William Fox, Center for Business & Economic Research University of Tennessee

	Total All Out of State Electronic Sales	Total All Out of State Sales
Alabama	170,400,000	347,734,399
Alaska	*1,500,000*	*3,035,981*
Arizona	369,800,000	708,628,254
Arkansas	*113,900,000*	*236,311,930*
California	*1,904,500,000*	*4,159,667,947*
Colorado	172,700,000	352,563,574
Connecticut	63,800,000	152,367,405
District of Columbia	35,500,000	72,517,182
Florida	*803,800,000*	*1,483,690,010*
Georgia	*410,300,000*	*837,610,389*
Hawaii	*60,000,000*	*122,514,495*
Idaho	46,400,000	103,120,482
Illinois	506,800,000	1,058,849,588
Indiana	195,300,000	398,817,708
Iowa	88,700,000	181,012,560
Kansas	142,900,000	279,224,028
Kentucky	109,900,000	224,484,309
Louisiana	395,900,000	808,311,357
Maine	*32,100,000*	*65,430,824*
Maryland	184,100,000	375,944,240
Massachusetts	*131,300,000*	*268,002,460*
Michigan	141,500,000	288,954,339
Minnesota	*235,300,000*	*455,219,250*
Mississippi	*134,900,000*	*303,286,360*
Missouri	*210,700,000*	*430,191,928*
Nebraska	61,300,000	118,052,068
Nevada	*168,900,000*	*344,923,618*
New Jersey	*202,500,000*	*413,390,425*
New Mexico	*120,500,000*	*245,989,786*
New York	865,500,000	1,766,968,251
North Carolina	213,800,000	436,517,492
North Dakota	15,300,000	31,274,219
Ohio	307,900,000	628,613,189
Oklahoma	140,800,000	296,348,658
Pennsylvania	*345,900,000*	*706,241,542*
Rhode Island	29,000,000	70,436,458
South Carolina	*124,500,000*	*254,290,538*
South Dakota	*29,800,000*	*60,826,849*
Tennessee	410,800,000	748,480,889
Texas	*870,400,000*	*1,777,090,593*
Utah	88,500,000	180,658,961
Vermont	25,100,000	44,759,329
Virginia	*207,000,000*	*422,651,971*
Washington	*281,900,000*	*540,968,704*
West Virginia	*50,600,000*	*103,284,206*
Wisconsin	142,100,000	289,006,114
Wyoming	28,600,000	61,744,705
Total	*11,392,700,000*	*23,260,009,564*

We believe that the Marketplace Fairness Act would allow the states to close this significant and growing loophole in our sales tax revenue and level the playing field for all sellers regardless of the medium used to conduct a transaction. S. 1832 also ensures that our constituents do not fall guilty to tax avoidance. While the $23.3 billion in uncollected sales taxes will not much any funding reductions from the Federal Government, it will provide state with some fiscal relief. In the words of Senator Roy Blunt, a sponsor of this legislation, it is "fiscal relief for the states that does not cost the Federal Government a single dime."

Thank you.

PREPARED STATEMENT OF THE NATIONAL ASSOCIATION OF CHAIN DRUG STORES

Chairman Rockefeller, Ranking Member Hutchison, the National Association of Chain Drug Stores (NACDS) thanks you for the opportunity to provide a written statement to the Committee on Commerce, Science & Transportation hearing on, "Marketplace Fairness: Leveling the Playing Field for Small Businesses."

NACDS represents traditional drug stores, supermarkets, and mass merchants with pharmacies—from regional chains with four stores to national companies. Chains operate more than 40,000 pharmacies and employ more than 3.5 million employees, including 130,000 pharmacists. They fill over 2.6 billion prescriptions annually, which is more than 72 percent of annual prescriptions in the United States. The total economic impact of all retail stores with pharmacies transcends their $900 billion in annual sales. Every $1 spent in these stores creates a ripple effect of $1.81 in other industries, for a total economic impact of $1.76 trillion, equal to 12 percent of GDP.

We applaud the Committee for holding this hearing to examine the loophole that prohibits states from requiring Internet and other remote sellers to collect sales and use taxes. This loophole, created in 1992 by the Supreme Court opinion in *Quill Corp.* v. *North Dakota,* has resulted in an uneven playing field for local businesses such as chain pharmacies.

The retail pharmacy industry is highly competitive, with an average profit margin of 2 percent. Chain pharmacies compete in the marketplace aggressively, offering competitive prices on a wide variety of products, ensuring convenience for their customers, and providing prescription drugs and important healthcare services such as immunizations. Chain pharmacies are under constant market pressure to deliver a competitive value.

However, chain pharmacies, like other brick-and-mortar retailers, are at a competitive disadvantage, since the *Quill* decision provides online-only companies with a price advantage of as much as 10 percent. This inequity threatens the ability of Main Street businesses, which are so critical to the economic vitality of their communities, to compete.

Local businesses are not alone in the competitive disadvantage created by the *Quill* decision. States, struggling to address budget challenges in this difficult economy without raising taxes, are denied the ability to collect sales taxes that are already owed to them. In testimony on behalf of the National Governors Association, Tennessee Governor Bill Haslam estimated his state is unable to collect $400 million in sales tax annually—nationally an estimated $20 billion in sales tax goes uncollected each year (Statement of Governor Bill Haslam, U.S. House of Representatives, Committee on the Judiciary, July 24, 2012).

The inability of states to collect sales taxes owed to them has a direct impact on communities, limiting funding for roads, schools, healthcare services, law enforcement and other basic services. As Congress grapples with reducing the deficit, Federal funding to the states is likely to be reduced. This makes it even more critical to provide states with the ability to collect the taxes owed by their residents.

The problem of uncollected sales taxes will only increase as e-commerce grows. Forrester Research estimates Americans will spend $327 billion in 2016 shopping online, an increase of 45 percent from 2012 and a 62 percent increase from 2011 (Forrester Research, U.S. Online Retail Forecast, 2011 to 2016). Action is needed by Congress now to level the playing field for states and Main Street businesses.

NACDS supports, S. 1832, the Marketplace Equity Act, introduced by Senator Mike Enzi, as a means to address the growing problems of uncollected sales tax. We thank Chairman Rockefeller for co-sponsoring this important legislation, as well as other Committee on Commerce, Science & Transportation members Senators Blunt, Boozman, Inouye, Klobuchar, and Pryor. This bipartisan legislation would give states the authority to manage their sales tax laws, providing a path forward for states to collect sales taxes, simplify their sales tax statutes, and assist vendors with compliance, while providing for a robust small business exemption. Enactment of S. 1832 would help preserve Main Street businesses that are critical to the economic vitality of their communities and empower states to address their budget challenges without raising taxes, or adding to the Federal deficit. We urge all members of the Committee to co-sponsor S. 1832, report it favorably, and work towards its passage by the full Senate.

Thank you for the opportunity to share our views. We look forward to working with you on this important legislation.

PREPARED STATEMENT OF R. DAVID L. CAMPBELL,[1] CHIEF EXECUTIVE OFFICER AND JOAN WAGNON,[2] EXECUTIVE VICE PRESIDENT, THE FEDERAL TAX AUTHORITY, LLC

Alexander Hamilton wrote in *The Federalist* in 1788 that "individual States should possess an independent and uncontrollable authority to raise their own revenues for the support of their own wants."

Today the discussion about state sovereignty over matters of taxation continues unabated. State revenue directors have seen firsthand how the actions of the Federal Government have affected state and local revenues. Members of Congress are increasingly bombarded by requests for action because state laws are restrictive to business or seen as unfair. There are any numbers of examples where congressional action has been beneficial or harmful to states.

But the issue that has been most devastating to state and local government has resulted from Congressional inaction, rather than action: the failure of Congress to overturn Quill v. North Dakota.[3]

The Marketplace Fairness Act (MFA), S. 1832, sponsored by a bipartisan group of senators (Enzi, Durbin, Alexander, et. al.) is a good solution to the revenue problems of states, but more importantly, it gives states a better mechanism than they have now to collect the taxes they already levy.[4]

The MFA also corrects a growing imbalance between groups of retailers. Under the current court ruling, tax is collected on some sales and not on other sales of the exact same items. Why should tax be collected on a book or camera purchased from a local business and not on an identical item purchased from a mail order or Internet business?

Remote sales are growing at double digit rates.[5] However, states' inability to collect sales tax on these sales results in the erosion of the states' tax bases. Certainly this unfairness is not the hallmark of good tax policy! Congress is creating winners and losers among the retail community by its inaction.

Opponents cite two specific reasons for allowing this unfair situation to continue: (a) that remote collection would be overly burdensome and complex, and (b) that any systems necessary for remote collection would be prohibitively costly. This testimony will provide technical information for Congress to consider when evaluating those arguments.

I. The Complexity Argument

Technology has advanced considerably since the 1967 and 1992 Supreme Court rulings that created the current sales tax situation. Even the more recent of these, *Quill,* occurred before the first graphical browser was invented, before most homes

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[1] David Campbell, Chief Executive Officer of The Federal Tax Authority (FedTax), founded the company in 2008. FedTax is a Washington State Limited Liability Company with operations in Washington, Connecticut, and Kansas. Its management team includes highly experienced professionals who have been directly involved in building some of the most recognizable brands in e-commerce, including MasterCard, Google, WebMD, Microsoft, Expedia, and American Express.

[2] Joan Wagnon served as Secretary of Revenue in Kansas from 2003 to 2011. She also chaired the Streamlined Sales Tax Governing Board in 2008–9 and the Multistate Tax Commission from 2006 to 2008. She served on the Board of Directors of the Federation of Tax Administrators for 8 years before joining FedTax to work toward the passage of Federal legislation granting states' collection authority over remote sales.

[3] The notion that out-of-state retailers would find it overly burdensome to keep track of every state's sales tax rules can be traced directly to the 1967 Supreme Court ruling in *National Bellas Hess* v. *Illinois Department of Revenue.* In its majority opinion, the court ruled that "the many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle National's interstate business in a virtual welter of complicated obligations to local jurisdictions" (emphasis added).

In 1992, the matter of remote sales tax collection came before the Supreme Court again in *Quill* v. *North Dakota.* This time, the court reaffirmed the earlier *Bellas Hess* decision by a ruling of 8 to 1, primarily on the basis of *stare decisis.* The ruling went on to state, "[O]ur decision is made easier by the fact that the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve."

FedTax frequently cites the earlier *Bellas Hess* quote because it summarizes the ruling's basis in complexity and burden, which has rippled forward to the present day and created a tidal wave of unintended consequences. This ruling has shielded all out-of-state retailers from the obligation to collect sales tax, based on the notion that it would place too much of a burden on businesses. Perhaps it would have, in 1967. That was the year the floppy disk was invented at IBM.

[4] States typically depend on voluntary means of collecting from individuals, such as a voluntary line on the income tax form. Audit procedures, which are used for businesses, are ineffective for consumers.

[5] On Cyber Monday (the first Monday after Thanksgiving) in 2011, over $1.2 billion in sales were transacted online. On that day alone, approximately $58 million in sales tax went uncollected.

had Internet connections, and long before e-commerce forever changed the retail landscape. Today, forty-five years after *Bellas Hess* and twenty years after *Quill,* online marketplaces and auction sites easily manage millions of items for sale at any given moment.

Today, keeping track of a few thousand local tax rates and filing requirements is not an insurmountable technical, administrative, or financial burden. TaxCloud, the sales tax management system created by FedTax, proves this point by calculating and collecting sales tax on any purchase for any tax jurisdiction in the United States *in less than one second.* The service is free to all retailers.

The technologies necessary to create such a system are not new; they are well-established. In fact, they are currently being used throughout e-commerce. They are Application Programming Interfaces and Web Services. An Application Programming Interface (API) allows dissimilar and unrelated systems to communicate with each other using pre-established syntax and structure. Web Services allow APIs to be used for machine-to-machine interactions over the internet. Both are now commonly used in e-commerce—for example, in real-time-shipping, which allows a retailer to provide its customers with accurate, real-time quotes for shipping costs based on at least five variables, including weight, size, delivery speed, origin, and destination. Often customers can even compare shipping costs among multiple shippers.

With APIs, Web Services, and other technological advances of the past twenty years, it is now possible for remote retailers to easily keep track of every state's tax laws.

To minimize or completely eliminate the undue burdens cited in *Bellas Hess* and *Quill,* more than half of the states with sales tax have worked together for twelve years to create the Streamlined Sales and Use Tax Agreement (SSUTA). These states provide free rates and boundaries databases for all of their respective taxing jurisdictions, and regularly issue updates when rules, rates, or boundaries change. In addition these states also certify and pay for software and service providers to manage sales tax compliance on behalf of retailers.[6] The Marketplace Fairness Act requires that any states seeking remote collection authority shall comply with SSUTA or provide comparable rates and boundaries information as well as certified software and services that retailers can rely upon to achieve compliance with minimal burden.[7]

Ironically, those who argue most strenuously that remote collection would be too complex are a few large online businesses that already rely on these same technologies every day, in every transaction. The plain fact is that eBay operates the largest marketplace in the history of the world by relying on technology to simplify and automate a host of historically burdensome chores, including payment automation, location-specific marketing, personalized recommendations, and for foreign governments, they even help their sellers manage Duties and Value Added Tax—Why don't they help their sellers manage sales tax in the United States? Simply put, because they don't have to.

II. The Costs-of-Compliance or Undue Burden Argument

Opponents also argue that even if technology can solve the technical burden of keeping track of rates, jurisdictions, and filing complexities, such software would be prohibitively costly, particularly for small businesses. TaxCloud is provided to retailers at no cost—so the argument that such software would be prohibitively costly should be flatly disregarded. However, the costs-of-compliance argument also maintains that even if the software is free, businesses will still be burdened with the cost of integrating such software into their existing systems.

This line of argument ignores the reality that all but the very largest retailers rely upon pre-written software and/or online hosted platforms for e-commerce and order management. Retailers rely upon these systems to avoid the costs of developing, managing, and maintaining such systems on their own, costs that are magnified by the changing nature of e-commerce. It is no secret that e-commerce is constantly changing to respond to evolving cyber-crime threats, payments and security industry best-practices, and, yes, legislative requirements. When their retailer clients need to collect sales tax, platform vendors will provide ways for them to do so, embedded within the platforms that retailers already use.

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[6] FedTax has been designated a Certified Service Provider (CSP) by the Streamlined Sales Tax Governing Board specifically for its TaxCloud service. There are six CSPs and 24 member and associate member states.

[7] Although "software and services" is not defined in the Marketplace Fairness Act, likely it will include Application Programming Interfaces (APIs), Web Services, rates and boundaries databases, and a process for certifying service providers to process returns accurately under state laws.

E-commerce platform vendors are intensely competitive and focused; they take pride in not only complying with evolving requirements but often surpassing them, occasionally with stunning results. For example, much of the cloud computing infrastructure now transforming every corner of the technology sector can be traced to several of the largest e-commerce companies adapting to comply with the Sarbanes Oxley Act of 2002. Most platforms already provide basic sales tax management features for their clients. Upon enactment of MFA, these existing systems will quickly be adapted to ensure compliance.

An analogy can be made to the automotive industry. There are many cars on the road today, but almost all of them were produced by an easily identifiable group of manufacturers. In 1968, a Federal law was enacted requiring seatbelts in cars. Ignoring the role of manufacturers, proponents of the cost-of-compliance argument would have portrayed a situation in which every car operator in the United States had to pay for and install seatbelts in their cars. Obviously that's not the case; nor is it the case that retailers will need to pay for and install their own systems to handle sales tax collection.

To conclude, modern technology has made it easy for retailers to collect sales tax for any address in the United States. TaxCloud enables retailers of any size to easily collect sales tax and comply with the provisions of The Marketplace Fairness Act—for free. More information is available at *TaxCloud.net.*

And in addition to TaxCloud, five other companies are certified by the Streamlined Sales Tax Governing Board and ready to assist when Congress authorizes collection—and no doubt hundreds more will emerge soon after legislation is passed, because the free-market system will provide the incentive for entrepreneurs and innovators to develop these products.

Please enact the Marketplace Fairness Act. Passing this bill can be the foundation for future reform as well as provide great benefit to both state and local governments. Passing this bill benefits consumers, by shielding them from inadvertent tax evasion due to the unreasonable expectation of voluntary self-reporting and remittance of use taxes. Finally, passing this bill will benefit business large and small, by incentivizing states to modernize and simplify their sometimes arcane and incomprehensible sales tax rules. Congressional action is needed now more than ever to restore balance to the retail industry by guiding states to enact forum-neutral sales tax policies and ensure equal justice under law.

R. DAVID L. CAMPBELL,
Chief Executive Officer.

JOAN WAGNON,
Executive Vice President.

STATEMENT OF KELLY WILLIAM COBB, GOVERNMENT AFFAIRS MANAGER, AMERICANS FOR TAX REFORM

Introduction

Chairman Rockefeller, Ranking Member Hutchison, and Members of the Senate Commerce, Science, and Transportation Committee, thank you for the opportunity to submit written testimony on behalf of Americans for Tax Reform on the issue of remote state sales tax collection and physical presence.

Americans for Tax Reform advocates for a system in which taxes are simpler, flatter, more visible, and lower than they are today. However, ATR is concerned that the Marketplace Fairness Act (S. 1832), sponsored by Sens. Dick Durbin (D–Ill.) and Mike Enzi (R–Wyo.), would not only raise tax revenue on net for states, but also fail to adequately simplify the tax code and erode the physical nexus standard that protects Americans from the tax laws of other states.

Under the U.S. Supreme Court's ruling in *Quill* v. *North Dakota,* it is a violation of the Commerce Clause for a state to require an online or remote retailer without a physical presence in that state to collect and remit the sales tax. This is not a "tax loophole" as some would suggest, but law derived directly from the U.S. Constitution. The Marketplace Fairness Act would overturn the *Quill* decision, permitting overzealous state tax collectors to reach well outside their borders to force online and other out-of-state retailers to collect their state's sales tax.

The effects on taxpayers of the Marketplace Fairness Act and similar legislation would be dramatic. From a taxpayer perspective, any bill that touches remote sales taxes must preserve the physical presence standard and protect consumers on net from a higher tax burden. Unfortunately, the Federal online sales tax bills miss the mark widely on both fronts.

State-level Tax Burden Will Increase

Proponents of Federal Internet tax legislation repeatedly claim that the measure is not about new taxes. The Marketplace Fairness Act even includes a section called "No New Taxes," which enshrines little into law except rhetoric. Yet, proponents are also quick to point out that it would raise as much as $23 billion in tax revenue from consumers at the state level.

While consumers do currently owe "use tax" on products they purchase online and out-of-state, compliance is scant and most states have failed to even undertake basic enforcement mechanisms, such as including use tax collection on income tax forms.

Yet, use tax is simply not the same as a sales tax, which is actually owed by retailers that may legally pass the tax liability onto consumers. Where they do find common ground is their basis in the current physical nexus standard: businesses with a physical footprint in a state remit "sales tax," and consumers with footprint remit "use tax."

The Marketplace Fairness Act would force out-of-state retailers to collect and remit sales taxes—to say nothing of consumer-paid use taxes. This is a fundamental change in tax law and certainly a new form of taxation. Furthermore, for the numerous retailers who do not pass sales tax liability onto their consumers at the register, this legislation amounts to a new out-of-state tax that will come directly out of a business's bottom line.

Proponents also claim remote sales are "eroding" the sales tax base and without Federal action states will raise other taxes to compensate for a drop in revenues. First, this grossly overstates whatever problem might exist. According to one study, this so-called erosion amounts to "less than three-tenths of one percent of state and local tax revenues."

Second, it ignores that states can also solve budget shortfalls by cutting spending. As GDP plummeted during the last recession, states increased spending by 8.4 percent. Fiscally responsible lawmakers should not be encouraging states to engage in such profligate spending by pushing for a measure that will raise as much as $23 billion in tax revenue at the state level.

Dissolving Physical Nexus Weakens a Fundamental Taxpayer Protection

The physical nexus standard is a staple of our tax code, preventing states from reaching across their borders to force out-of-state businesses or individuals to comply with their tax codes—whether it be collecting, remitting, or even paying taxes. The Marketplace Fairness Act will dissolve this physical nexus requirement for collecting sales taxes.

The Marketplace Fairness Act also opens the door—at least to conversation—about other forms of "economic nexus" standards that would permit states to apply their tax codes to non-residents with mere economic presence in the state. Codified in many different forms across the country, the economic standard grants nebulous authority to force out-of-state, non-residents to comply with a state's tax code. The gradual shift to economic nexus is an attempt by states to raise tax revenue beyond what their own economies and taxpayers can sustain.

Economic nexus poses a direct threat to the principle of republican governance by the people, shifting the cost of government to non-residents. It also violates the "benefits principle" by pushing the tax burden onto those that receive no direct benefit from the state.

To put it simply, measures to dissolve the physical presence standard have the potential to usher in the second coming of taxation without representation in America.

Outsources State Tax Rules to an Unelected Body

Under the Marketplace Fairness Act, twenty-four states operating under the Streamlined Sales and Use Tax Agreement (SSUTA) would be able to tax remote sales almost automatically. Remaining states would have to comply with a number of requirements or choose to join the Streamlined Sales Tax Project (SSTP).

Reliance on SSUTA allows a handful of tax administrators and state lawmakers on the Streamlined Sales Tax Governing Board—which has long advocated for tearing down the physical nexus standard for sales taxes—to control remote sales tax decisions for states and incents the states that are not part of SSUTA to join. Non-SSUTA states will watch helplessly as the "streamline states" hassle their resident businesses to collect more tax revenue.

Tax Code Complexity Will Increase

The Marketplace Fairness Act will force online, catalog, TV and other remote retailers to comply with over 9,600 sales tax jurisdictions across the country. First, whatever un-level playing field for tax collection does exist would be perpetuated—

not resolved—by the Marketplace Fairness Act. In fact, the scales would be tipped against remote retailers, who would have to comply with the 9,646 tax jurisdictions across the country, while brick-and-mortar stores would comply with only the one where they are located.

While SSTP purports to simplify the tax code, the Marketplace Fairness Act's reliance on it will further increase complexity. Since SSTP's creation over a decade ago, the number of sales tax jurisdictions across the country has skyrocketed. The roughly 8,000 tax jurisdictions in existence in 2009 have risen to 9,646 today—with an average of 651 new or different sales tax rates or jurisdictions every year.

Additionally, by attempting to define very specific goods and services, SSTP's pursuit of uniformity between state tax codes has created even worse complexity. For example, SSTP has long struggled with defining specific products, such as "candy" and "cereal" that can both contain very similar ingredients. Such Platonic collection-and-division-style tactics by SSTP to create uniformity and simplicity not only create enormous complications in our tax codes but also are by design destined for failure. Instead, states should work toward the opposite end: scrapping definitions for individualized goods and services.

SSTP also allows for diverse and discriminatory tax rates on various goods, even to the point of carving out exceptions for various member states. Defining goods more generally instead of individually would also help to eliminate discriminatory state and local tax rates on specific goods.

While it is true that software—if frequently updated—could calculate the sales tax rate for each jurisdiction, software cannot keep track of the varied definitions for taxing goods and can hardly advise a retailer of these complex determinations. A computer cannot, for example, determine if a KitKat bar should be considered "candy" or more generally as "food," since items that contain flour under SSTUA are not considered candy. This is but one example of controversial determinations made by SSTP.

Preserving Physical Nexus and Preventing a Higher Tax Burden

Instead of pursuing the Marketplace Fairness Act, Congress should look toward strengthening the physical presence standard, which is being slowly eroded by revenue-hungry states. With regard to remote sales, origin-based sourcing—whereby tax is based on the jurisdiction of the seller rather than the buyer—is one option to preserve the physical nexus standard while addressing remote sales.

Regardless of the path, any effort to tax remote sales must preserve physical nexus and be made revenue neutral at the state level to ensure that the net tax burden on consumers does not rise.

The Senate should also take up legislation that would help to strengthen the physical presence standard in other ways. Lawmakers should consider the Business Activity Tax Simplification Act, or BATSA (H.R. 1439), which has been introduced in the U.S. House of Representatives by Rep. Bob Goodlatte (R–Va.).

BATSA establishes a clear physical presence standard for taxing multistate businesses engaged in cross-border transactions. The bill will help to foster inter-state economic activity by eliminating the burden for businesses of having to comply with varying and complex state income tax laws. As Congress considers measures like the Marketplace Fairness Act and as nearly half of states have already sought to loosen their physical nexus standard, BATSA could not come at a more critical juncture.

Conclusion

Congress has well-established Constitutional authority to regulate interstate commerce and related tax laws. However, with that tool in mind, it is critically important that Congress work toward lowering the tax burden and strengthening the physical nexus standard that was reaffirmed in *Quill* v. *North Dakota.* Unfortunately, the Marketplace Fairness Act and similar measures under consideration by Congress today would do the opposite.

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
Providence, RI, August 1, 2012

Hon. JOHN D. ROCKEFELLER IV,
Chairman
Committee on Commerce, Science, and Transportation,
U.S. Senate
Washington, DC.

Hon. KAY BAILEY HUTCHISON,
Ranking Member,
Committee on Commerce, Science, and Transportation,
U.S. Senate
Washington, DC.

Dear Chairman Rockefeller and Senator Hutchison:

Thank you for scheduling a hearing on an important piece of legislation for all states, S. 1832, *The Marketplace Fairness Act*. This bipartisan bill, introduced by Senators Alexander (R–TN), Durbin (D–IL), Enzi (R–WY), and Johnson (D–SD) would authorize states that are members of the Streamlined Sales and Use Tax Agreement to collect state sales taxes from online remote vendors on transactions into their states that are already owed to state governments.

I have long advocated for passage of Main Street fairness legislation, and last year I sent letters to every Governor encouraging their support of Federal legislation. This bill presents an opportunity for states to modernize their tax systems and perhaps more importantly to the business owner, helps level the playing field between Main Street stores and online retailers.

While it is estimated that Rhode Island would collect an additional $70.4 million in sales and use tax remittance from remote sellers in the first year after passage of Federal legislation, my commitment to fairness between bricks and mortar retailers and online sellers runs deeper than that. The Fiscal Year 2012 state budget that I signed into law included a provision that would trigger a reduction of the state sales tax from 7 percent to 6.5 percent if Federal Main Street fairness legislation passed; and this Fiscal Year 2013 budget that I approved includes an elimination trigger of an expanded sales tax on clothing purchases greater than $250 that would exempt state sales tax collection on clothing purchases. With those two provisions in Rhode Island state statute, passage of *The Marketplace Fairness Act* would have a net impact of $457,854 in increased revenue. However, at the end of the day, Rhode Island businesses will be able to compete on a level playing field with online sellers, and Rhode Island consumers will benefit from a reduced state sales tax burden.

As I have traveled across my state visiting communities and talking to businesses, this topic of fairness often comes up. A bookstore owner in Middletown tells me about patrons browsing books in the store, only to leave without making a purchase. Is it fair for that Main Street store to lose business to online companies just because online retailers are not collecting state sales tax? Internet shopping is not going away, and it is clearly time to treat similar sales transactions equally.

As many states and businesses continue to struggle in this economy, I encourage you to authorize states to collect sales and use taxes on online sales and give local businesses the opportunity to compete fairly with online retailers. I urge you to support *The Marketplace Fairness Act* and act swiftly to markup and ultimately pass this legislation.

Sincerely,

LINCOLN D. CHAFEE,
Governor.

cc: Members of the Senate Commerce, Science, and Transportation Committee

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August 1, 2012

Hon. JOHN D. ROCKEFELLER IV,
Chairman,
United States Senate Committee on Commerce, Science, and Transportation,
Washington, DC.

Hon. KAY BAILEY HUTCHISON,
Ranking Member
United States Senate Committee on Commerce, Science, and Transportation,
Washington, DC.

Dear Chairman Rockefeller and Ranking Member Hutchison:

Thank you for convening a hearing to explore changes to Federal policy that would require U.S. businesses to collect and remit sales taxes for purchases made by remote customers. Changes to Internet sales tax law have long been of importance to the eBay Marketplace and the hundreds of thousands of small businesses and entrepreneurs that use our platform.

While eBay Inc. is a large company, we have an interest in small retail businesses' success and growth. For the past 16 years, the eBay Marketplace has served as a platform for small business retailers and a tool to encourage small business development and entrepreneurship. We are a facilitator for small business retailers—not a competitor—and we have experienced firsthand the challenges that small retailers face in the current retail environment.

In November 2011, I appeared before the U.S. House Committee on the Judiciary to testify on the issue of sales taxes on the Internet, representing the interests of our company and the small businesses we serve. At the November 2011 hearing, I shared eBay's concerns that proposed Internet sales tax policies, including the Marketplace Fairness Act (S. 1832), would negatively impact small business retailers in every state.

The ability of small business retail to play a meaningful role in the 21st Century retail marketplace is critical for expanding retail competition, developing new businesses and better serving consumers. I would like to reaffirm our support for small business protections and reiterate three of eBay's major concerns with the current Internet sales tax debate:

- *Big Retail* v. *Small Retail:* Multi-billion-dollar retailers increasingly dominate online retail, just as they do "in-store" retail. Even under current sales tax law, small online retailers have lost 11 percent of their share of the U.S. e-commerce market in just two years. What would happen when they would be forced to collect and remit in over 9,600 tax jurisdictions, driving up the costs of their products in states where they do not have stores and distribution centers to use to serve customers locally?
- *Fairness and Sameness:* Many have claimed that "fairness" means that all retailers using the Internet should be held to the same remote sales tax standard. Under the status quo, small businesses are not treated the same as their larger competitors. For example, small businesses do not benefit from volume-driven pricing or shipping prices, and small businesses do not benefit from local and/or state tax deals that the large national retailers often receive. Is it really fair that small businesses should be held to the same tax collection standard as mega-retailers?
- *Misleading Data:* There are those that believe small businesses should not be protected from new sales tax burdens. In an effort to sway policymakers, Amazon and other supporters of the Marketplace Equity Act have publicized a study entitled, *Online Retail Sellers and Sales Volume Thresholds,* which suggests a majority of small businesses would be protected by the small seller threshold contained in the dominant House and Senate Internet sales tax bills. The study is deeply misleading, as it distorts retailer data by including millions of consumers who occasionally sell on the Internet in its data. In short, very small volume casual sellers (the Internet-enabled equivalent of garage sales) are counted as retailers in that study in an attempt to validate imposing tax burdens on retailers that are very small businesses.

The Internet and Small Business Growth

eBay Inc. connects millions of buyers and sellers across the globe everyday through the eBay platform, which is the world's largest online marketplace and through PayPal, which enables individuals and businesses to securely, easily and quickly send and receive online payments. We also reach millions of consumers through specialized marketplaces such as StubHub, the world's largest resale ticket marketplace, and eBay Classifieds sites, which, together, are available in more than 1,000 cities around the world.

Among those that use the eBay platform are hundreds of thousands of U.S. small businesses and entrepreneurs who are located in every state and congressional district in the country. The Internet and the eBay marketplace provide these small businesses and entrepreneurs with relatively low-cost access to potential buyers far outside the limits of their traditional geographic footprint. Small business retailers have always been at the heart of the eBay business model, and eBay cares about how Federal legislation impacts them.

Regardless of the size of a retailer, technology and the Internet are now central to almost every retail business model. By opening up new markets, the Internet empowers particularly small businesses to reach a global consumer base, opening up international markets to small business retailers in ways unimaginable just fifteen years ago. So, the very idea that this debate is about "Online Retail" v. "Offline Retail" is a false paradigm. All 21st Century retail business models have some physical facilities, whether stores, management offices, warehouses or distribution centers, and use the Internet alongside other technology tools.

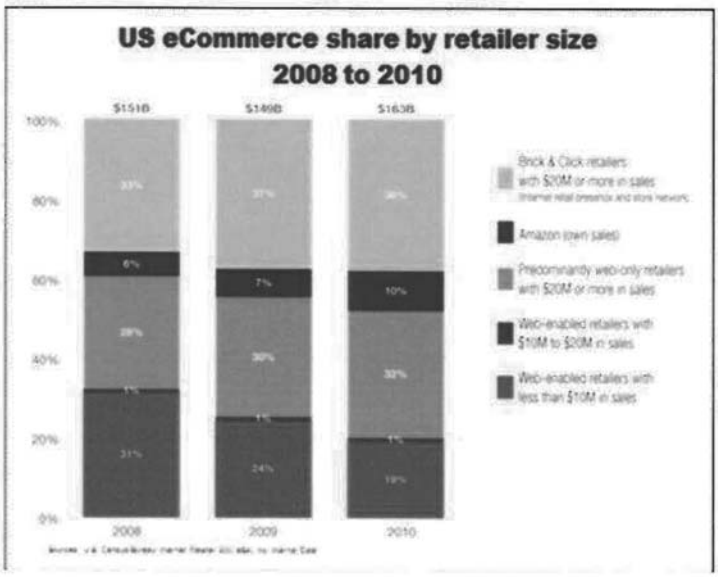
Big Retail v. Small Retail

The sales tax debate has really come down to "Big Retail" v. "Small Retail" and whether or not it is smart public policy to treat a small business retailer the same as a multi-billion dollar retailer. Over the past 30 years, giant retailers have grown more dominant, while small independent retailers have been pushed to the edges. As I testified in November 2011, big-box retailers accounted for 42 percent of total retail sales in 1987. As of July 2010, their market share had jumped to 87 percent.[1] In addition, retail giants make up 18 of the Top 25 retail websites today. eBay is not calling on the Congress to change laws to turn this trend around, but we do oppose changes in law that would disadvantage small retailers online.

Retail giants are trying to use a bill named the Marketplace Fairness Act (S. 1832) to disadvantage small businesses and require them to have the same tax burden, even though they do not have the physical presence or other benefits that larger retailers enjoy. For example, Amazon has been a retailer with facilities in the state of Tennessee, along with over 20 other states, for many years and, yet, has not been required to collect sales taxes in the state. Amazon has successfully leveraged its size in states across the country to receive an exemption from collecting sales taxes for several years in exchange for adding to their in-state facilities. Interestingly, these same deals have not been applied to the small businesses that use their platform.

The small business retailer, when using the Internet to compete for sales with customers who are far away, does not benefit from local facilities. They enter the fray without the benefit of stores, distribution centers and other local facilities that can help serve customers. On the other hand, the largest retailers have national store or distribution networks and can offer key services like in-store pick up, fast and free shipping, and in-store returns of items bought online. Consumers value those features, and as a result, large retailers are commanding more and more market share year over year.

While small business retailers are active online and are adopting technology, they do not enjoy any particular advantage, as previously stated, and, instead, face significant competition from large retailers that are also adopting the full range of technologies. Small business retailers using the Internet face meaningful threats. In fact, market share data helps cut through the rhetoric and illustrates that small business retailers face meaningful challenges today without a new tax burden being placed on them by the U.S. Congress.



[1] ConsumerReports.org. (July 2010). *America's Top Stores: 30,000 Readers Reveal the Best Places to Shop for Practically Anything.* Consumer Reports

Moreover, if small business retailers using the Internet were gaining unfair advantages from current remote sales tax laws, one would expect that their share of Internet sales would be growing. As you can see from the chart on the previous page, that is not the case. Just as importantly, the idea that small business retailers on the Internet are a threat to the survival of small business store fronts is ridiculous. The threat to small independent retailers is coming from giant multi-billion-dollar competitors online and offline, which has been the case for nearly half a century. Taking the tax burden that comes with those local services and applying them to a remote small business will further tip the playing field against the small business retailer.

Fairness and Sameness

Some have claimed that a "level playing field" means all retailers, big and small, remote and in state, should collect the *same* sales taxes. However, it is important to keep in mind that the retail playing field is already un-level. We all know that small business retailers have proportionally higher costs of doing business. As previously mentioned, there are also many direct tax benefits enjoyed by the largest retailers that never flow down to their small business competitors. These include state and local property tax breaks and sales tax exclusions, like the Amazon example outlined above.

There has also been discussion about how the current remote sales tax structure is unfair for state and local governments that face financial challenges in this current economic environment. eBay is sympathetic to states' budget difficulties; however it is important to point out that recent reports have indicated that with the rise of the "Brick and Click" retailers who are now collecting and remitting in most tax jurisdictions, the amount of uncollected revenue has actually been dramatically reduced. In fact, according to a study by economists Jeffrey Eisenach and Robert Litan, uncollected revenues (from firms with more than $5 million in remote sales) will average approximately $2.67 billion over the 2008–2012 period, or about two-tenths of one percent of total state and local tax revenues.[2] Is it really fair to adopt a blanket sales tax law that would disadvantage small business retailers using the Internet for about two-tenths of one percent of total state and local tax revenues?

In addition, in a recent report by the National Governors Association and the National Association of State Budget Officers, it appears state revenues are starting to improve, and 38 states reported that they had higher general fund spending in fiscal 2011 compared to fiscal 2010.[3] While the recovery is ongoing, states are rebounding from the recession. Should we be placing additional burdens on small business job creators and jeopardizing their continued ability to contribute to state coffers through economic growth?

Also, many states have chosen not to enforce their consumer Use Tax laws and have, instead, opted for an approach that would burden out-of-state businesses. Certainly, the Marketplace Fairness Act is a politically expedient alternative for state officials that are uninterested in enforcing their own laws. However, is it fair to authorize state tax commissioners to enforce their tax laws on non-resident businesses and jeopardize small businesses development with unforeseen costs?

At eBay, we believe that if fairness truly is the goal of policy proposals, then current remote sales tax policies should be preserved for small businesses. Unfortunately, the Marketplace Fairness Act walks away from small business protections by dropping the "small business exemption" included in previous legislation and replacing it with a "small seller exception" that protects the Internet version of garage sales and hobby sellers. It is entirely fair to allow small business retailers to collect taxes only where they operate their business.

Misleading Data

There have been studies that claim that current Internet sales tax proposals protect over 99 percent of online sellers.[4] The members of the Committee should be wary of these claims since the relied upon study does not differentiate between casual sellers who occasionally sell on the Internet and actual small business retailers that use the Internet as an integral part of their business.

It is misleading to include occasional sellers in studies that claim to illustrate the impact of a tax increase on small businesses. No one expects an individual that casually sells their unwanted stuff online to collect and remit sales taxes the same way

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[2] Uncollected Sales Taxes on Electronic Commerce: A Reality Check"; Eisenach and Litan: 2010.

[3] "The Fiscal survey of States: 2011": *http://www.nasbo.org/sites/default/files/2011%20Fall%20Fiscal%20Survey%20of%20States.pdf*

[4] Malowane, Laura and Stephen Siwek. *Online Retail Sellers and Sales Volume Thresholds.* Washington, D.C.: Economists Incorporated, 2010.

no one expects a garage sale to collect sales taxes. Distorting retailer data by including millions of consumers who occasionally sell on the Internet is an effort to hide the real negative impact on real small business retailers who are working to provide meaningful competition to established retail giants.

Real Small Business Protection

If you believe that real small businesses should not be harmed by a change in remote sales tax law, then the definition of a small business is an important one. Congress traditionally delegates authority to the Small Business Administration (SBA) to set small business size standards. The SBA's unique position allows it to take into account the intricate differences in diverse business models.[5] While eBay does not think the SBA should blindly adopt otherwise developed small business definitions (namely the SBA lending standards), we do think that the SBA could fairly define the profile of the small business that should be exempt from sales tax collection burdens.

It is important to note that every previous remote sales tax proposal until the 111th Congress has included small businesses protections, recognizing the playing field is unequal for small businesses. More specifically, proposals introduced in the 107th through the 110th Congresses included a small business exemption of at least $5 million, or authorized the SBA to establish the exemption threshold.

The current small seller exemption in the legislation being considered today is not only arbitrary and significantly below SBA levels, it is well below other small business definitions, such as the single $10 million in revenue level proposed last year by the U.S. Department of the Treasury. Tax legislation passed in both chambers has included an employee threshold to protect small businesses, and an employee threshold could offer a good method of setting an appropriate small business exemption in this context as well.

There will always be retail small businesses and emerging small businesses, and they will always be deserving of relief from national-level tax collection in order to promote their growth into major retail businesses. For all of these reasons, eBay strongly supports S. Res. 309. This bipartisan resolution opposes new tax collection requirements for small online businesses and entrepreneurs. The Resolution, which was introduced by Senator Wyden and Senator Ayotte, calls for policies to maintain the principle that small businesses should not be held to the same standard as large retail businesses with significant presence.

To conclude, eBay's business is to help the small businesses that use our platform succeed in a challenging and rapidly changing retail world. Not surprisingly, our focus has been to protect small business retailers using the Internet. eBay strongly supports a robust small business exemption being included in any new remote sales tax regime and will continue to urge members of the Committee to do the same.

Sincerely,

TAD COHEN,
Vice President and Deputy General Counsel,
Government Relations,
eBay Inc.

[5] Small Business Administration 2012 size standards: *http://www.sba.gov/content/table-small-business-sizestandards*

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North America – U.S.
Retail Sales/Taxes
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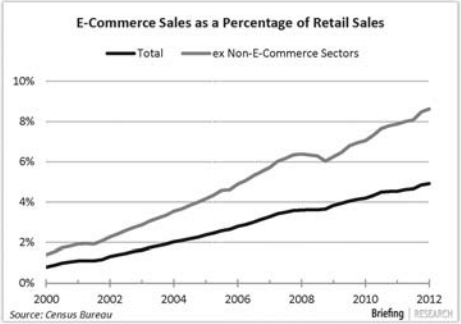
The Taxman Cometh Online

As a result of the 1992 Supreme Court ruling on *Quill Corp. v. North Dakota*, businesses were not required to collect sales taxes on behalf of state or local governments unless the business had a nexus of operations in the state. That ruling gave a price advantage at least the size of the sales tax to mail-order and/or Internet companies over traditional brick-and-mortar establishments.

The price advantage is not chump change. According to the National Conference of State Legislatures, states lost $18 bln in uncollected taxes in 2008, of which $7.7 bln were the result of online transactions. They estimate that lost tax revenues will jump to $23 bln in 2012, with roughly $12.5 bln coming from e-commerce.

With local retailers struggling from the price disadvantages amid the weak economy and state and local governments in need of revenues after the housing bubble crash, new laws have been enacted with limited success that force Internet retailers to collect sales taxes.

That is likely to change, however.



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Online vs. Brick-and-Mortar

Amazon.com (AMZN) and the state of California came to an agreement in 2011 that required Amazon to start collecting state and local sales taxes beginning in September 2012. Amazon agreed to set up a fulfillment center in San Bernardino. In return, San Bernardino extended tax breaks to Amazon that nearly equaled the local taxes Amazon was set to collect.

Similar agreements were negotiated between Amazon and the state of Texas, forcing the e-retailer to collect the 6.25% state sales tax on all sales starting July 1, 2012.

Another agreement with the state of Nevada will call for Amazon to collect that state's 8.1% sales tax beginning on Jan. 1, 2014.

As Amazon goes, the rest of online retailing will follow.

Bipartisan support in Congress is growing to pass the Marketplace Fairness Act. Once enacted, this law would standardize the collection methods of sales taxes for online transactions, which would make it easier for companies to comply with state and local sales tax laws. Small businesses with sales of less than $500,000 would be exempt from the requirements.

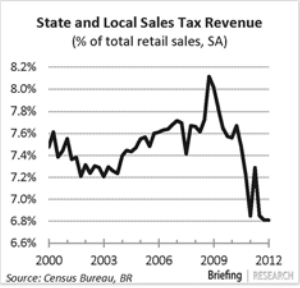
There is also the Marketplace Equity Act, which is a similar bill and was introduced in the House instead of the Senate. They key difference is that this bill says small businesses with sales of less than $1 mln, or less than $100,000 in a specific state, would be exempt from the requirements.

Wal-Mart (WMT) is a proponent of the bill (one of the authors of the legislation is Republican Representative Steve Womack from the company's district in Arkansas). The company has been stepping up its lobbying efforts as it faces increasing competition from online retailers such as Amazon.

In essence, Amazon is being proactive and positioning itself for the inevitable. By negotiating peacefully before Congress acts, Amazon is able to reap the benefits of large tax breaks whereas other online retailers will find themselves stuck with less competitive prices without any recourse.

From an Economic Perspective

Currently, the average state and local sales tax rate is over 9.6%. Yet, state and local governments are only collecting an effective rate of 6.8%. A large portion of the spread between the actual and effective rates was the result of stronger online demand, especially over the last few years. The Marketplace Fairness Act, or something similar, would mitigate some of the loss.



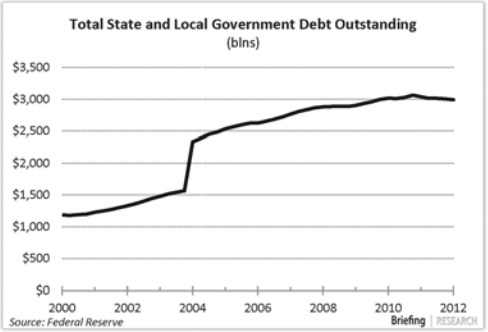
Some lobbyists for the online retailers are contending that these new requirements are actually a new consumption tax. That is not necessarily true.

Note: The five states without sales tax are Alaska, Delaware, Montana, New Hampshire and Oregon.

All 45 states that have sales taxes require consumers to collect the tax on online transactions themselves and submit them when filing taxes each year. States, however, lack proper enforcement gauges and audit abilities. Thus, most consumers understate the sales taxes they actually owe.

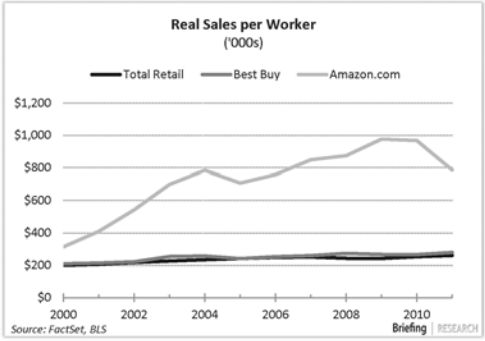
The benefits to state and local governments and brick-and-mortar retailers should outweigh the decline in consumers' disposable income.

State and local governments currently have nearly $3.0 tln in outstanding debt. While the recovery of lost tax revenue will not be enough to pay off the debt, it will help prevent more cuts to projects and services until the economy fully recovers.



On the business side, retailers like **Best Buy** (BBY) will see their prices become more competitive with online retailers. That should boost overall retail sales, increase profits, alleviate pressure to cut payrolls further, and improve hiring conditions.

At the same time, online retailers, like Amazon, generally do not have large workforces or sales staffs. The loss of online sales will lower online retailer profits, but should have few negative effects on overall employment levels.



That means the collection of sales taxes by online companies should result in a net gain in aggregate wages as stronger employment levels at brick-and-mortar establishments more than offset the potential losses from online retailers.

From a Corporate Perspective

Notes: This is not an exhaustive list, and for each online retailer more brick-and-mortar competitors could be listed.

We chose not to include Bidz.com (BIDZ) with Blue Nile as the former is being acquired by Glendon Group.

Examples of online retailers and competing brick-and-mortar stores include:

- Amazon.com versus **Barnes & Noble** (BKS), Best Buy and Wal-Mart

Reports in the *Wall Street Journal* and the *Financial Times* suggest that Amazon may be deploying new fulfillment centers as a way to initiate same-day delivery. That would eliminate the main advantage that brick-and-mortar establishments have over Amazon.

Thus, Amazon would not only see benefits from tax breaks, but demand for its products would increase as consumers are able to receive purchases without shipping delays. That thought will likely be a key point of contention going forward for brick-and-mortar retailers aiming to level the playing field with Amazon and other online retailers.

- **Blue Nile** (NILE) versus **Harry Winston Diamond** (HWD), **Tiffany** (TIF) and **Zale** (ZLC)

Blue Nile said in its most recent 10-K that "net sales may be negatively affected if we are required to collect taxes on purchases and/or disclose our customers' private

information to tax authorities." The company currently only collects sales taxes in Washington, New York and certain foreign countries.

- **Overstock.com** (OSTK) versus **J.C. Penney** (JCP), **Kohl's** (KSS), **Macy's** (M) and **Sears Holding** (SHLD)

Overstock also discussed the sales tax issue in its most recent 10-K. The company said "new state tax regulations in states where we do not now collect state and local taxes, may subject us to the obligation to collect and remit state and local taxes, or subject us to additional state and local sales and income taxes, or to requirements intended to assist states with their tax collection efforts." It believes these tax collection obligations could have an adverse effect on cash flows and results of operations, as well as the possibility the company may be subject to "significant" fines or other prepayments for any past failures to comply with these requirements.

Finally, **eBay** (EBAY) has been campaigning against federal legislation. The company is different than the online retailers mentioned above because it provides a platform for other retailers to sell products. It does not, however, collect taxes on goods or services sold by users of eBay.

The company said in its most recent 10-K that "collection responsibility and the additional costs associated with complex use tax collection, remittance and audit requirements would make selling on our websites less attractive for small business retailers, and would harm our business."

The company expects online sales tax to happen at some point. It said on its second quarter conference call that the goal is to mimic efforts in California, where it worked with legislature to create a small business exclusion for retailers who sold less than $1 mln in the state.

Conclusion

From an economic perspective, there is little negative impact – and perhaps some positive impact – from an increase in tax revenue and a more level playing field in the retail sector.

From a corporate perspective, the battle is only in the initial stages. As the political story plays out, other online retailers are likely to go the route of Amazon (and eBay) by negotiating regional/state agreements to mitigate the impact of potential tax increases.

At the end of the day, online retailers have gotten away with not paying/collecting taxes. Eventually, that will come to an end.

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Competitive Enterprise Institute—July 30, 2012—No. 180

THE MARKETPLACE FAIRNESS ACT WOULD CREATE A STATE SALES TAX CARTEL AND HURT CONSUMERS

AN ORIGIN-BASED SYSTEM OFFERS AN ALTERNATIVE FORWARD

By Jessica Melugin *

The rapid growth of online retailing has been accompanied by increasing calls by state and local officials to allow them to capture more sales tax revenue and by brick-and-mortar retailers to "level the playing field." The Marketplace Fairness Act (S. 1832) seeks to capture more tax revenue for states on Internet purchases.[1] Traditional retailers, states, and localities have urged Congress to act in the name of "fairness," but for consumers, this will only mean a tax increase. There certainly are inequities in the way online sales are taxed, but in the case of S. 1832, the cure is worse than the disease. If Congress is to consider Internet sales tax policy as part of broader tax reform efforts, an origin-based approach would address the legitimate need for sales tax reform and avoid the Marketplace Fairness Act's harmful consequences.[2]

Quill—*Not too Shabby.* The Internet is not a tax-free zone. At the Federal level, the Internet Tax Freedom Act of 1998 banned "special and discriminatory taxes" which states might impose, especially for transactions conducted over the Internet. State and local sales tax restrictions are dictated by a 1992 Supreme Court decision, *Quill Corporation* v. *North Dakota.*[3] In its *Quill* decision, the Court held that a state may not collect sales tax from retailers that have no physical presence, or nexus, within its borders unless Congress uses its Interstate Commerce powers to grant it explicit permission to do so; S. 1832 gives this consent.

Under current law, for example, when a Virginia resident buys a book online from a retailer in Oklahoma, Virginia may not collect sales tax on the purchase unless that Sooner bookseller has a nexus—such as a warehouse, store, or sales representative—in the Commonwealth. Technically, the Virginia resident may owe a use tax on the purchase, but these taxes are seldom enforced or collected. When proponents of remote Internet sales taxing argue that they are not calling for "new" taxes, they are referring to these obscure use taxes. For consumers who face increased costs for their online purchases, it is little consolation that those costs are not the result of new taxes, but of existing taxes newly collected.

The current arrangement is not an arbitrary loophole of tax law, but instead a manifestation of the principle of "no taxation without representation." It is vendors, not customers, who remit the sales tax to governments. And, much to the advantage of consumers, it is vendors, with their trade associations and eyes on the bottom line, who often put more organized pressure on politicians to keep tax rates low.

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* Jessica Melugin is an Adjunct Analyst at the Competitive Enterprise Institute in Washington, D.C.

The principles articulated in *Quill* also promote tax competition between jurisdictions. If state governments were allowed to tax vendors in other states, to whom they are not accountable, that would result in substantially less downward pressure on tax rates. Consumers would wear their states' tax burden like an albatross even when buying from companies on the other side of the country. When there is no exit for consumers, there is little incentive for politicians to keep tax rates reasonable.

The *Quill* decision also protects the free flow of interstate commerce. It spares sellers the burdensome task of remitting sales taxes to the approximately 7,400 different state and local taxing jurisdictions across the country. The Dallas-Fort Worth Airport has more than a dozen distinct jurisdictions alone.[4] The cost of these calculations would doubtless be passed along to customers and taxpayers.

The Marketplace Fairness Act would do away with all these benefits.

The Marketplace Fairness Act—the Good, the Bad, and the Really Bad. States and localities can already tax in-state sellers, to whom they are accountable, but S. 1832 seeks Congress' permission to tax those outside of their jurisdiction, to whom they are not accountable.

Specifically, the proposed legislation codifies into law the Streamlined Sales and Use Tax Agreement (SSUTA).[5] The stated goal of the SSUTA is to "simplify and modernize sales and use tax administration," and "substantially reduce the burden of tax compliance."[6] But the agreement also calls for Congress to overturn *Quill* and allow remote taxation, so the *un*articulated goal of the SSUTA is to form a de facto state tax cartel.[7] In practice, that means that member states agree to simplify their sales tax rates and bases, but only in exchange for the lucrative privilege of reaching beyond their borders to tax business in other states. So far, 21 states have joined the SSUTA as full members and tens of others are at various stages of compliance.

The above example of a Virginia resident buying a book online from an Oklahoma retailer would look very different under the SSUTA scheme. Virginia would be able to collect tax from the Oklahoma-based retailer despite the Oklahoma retailer having no physical presence in Virginia. Never mind that the company being taxed has absolutely no voice in what items Virginia decides to tax or at what rates it does so. And never mind that the company receives no benefit from any services Virginia provides with its tax dollars.

Even more alarming is a scenario where both the seller's state and the vendor's state may collect tax on the same transaction. The SSUTA agreement permits states that join and simplify their tax rates to periodically change their sourcing rules. This opens the door for double taxation. The Internet Tax Freedom Act currently prohibits this, but that protection expires in November 2014.

In any case, consumers will experience remote taxation as a tax hike. It is true that use taxes are already on the books—though, again, seldom collected and remitted—but that tax law technicality will be cold comfort to consumers paying more online for their purchases. Extracting more money from taxpayers to put in state and local tax coffers is, in plain fact, the objective of this legislation. The National Conference of State Legislatures itself has pointed out in a letter to Senators, "[i]n 2012, states will collectively lose an estimated $23.3 billion in uncollected sales taxes from out-of-state sales."[8] While that's not enough money to make up for state and local budget shortfalls, it's more than enough for voters to take notice.

Aside from raising tax revenue, proponents of this legislation also argue it will usher in an era of "fairness" in sales taxes between traditional brick-and-mortar retailers and remote sellers.[9] However, tax fairness is only one of many desirable characteristics of sound tax policy. Efficiency, preservation of federalism, privacy, and accountability all must be valued and balanced with an even playing field.

Despite the fairness mantra, S. 1832 sacrifices the goal of fairness with an exemption for smaller online sellers.[10] It would excuse sellers with less than $500,000 in gross receipts on remote sales in the preceding calendar year from having to calculate, collect, and remit sales taxes on remote transactions. Hence, the inequity between small bricks-and-mortar sellers and small online retailers will continue.

Moreover, the legislation is not particularly fair to the localities that will be forced to align their tax rates and base statewide. The Founders imagined many small policy laboratories in states, wisely acknowledging that governments closer to the people would be more responsive to those they served. Surely this idea also applies to localities within states. The language in the agreement requiring all localities to be homogenous in their sales tax policy flies in the face of this idea. It is, quite simply, an assault on local sovereignty.

Simplification is not all good news for taxpayers, either. A simplified tax base will inevitably involve an across-the-board expansion of what gets taxed. Currently, only about 40 percent of sales that could be taxed are taxed. Certain items enjoy exemptions for a variety of reasons. Foods are frequently viewed as staples. Similarly, a

town might exempt the product of its local industry. In the simplification process, each area's exemptions can't be made universal without narrowing the tax base to the vanishing point. Since that would defeat the whole point of increasing states revenue, states will have to take the opposite tack and harmonize upward. Items subject to tax anywhere will be subject to tax everywhere.

The legislation is not fair to the online retailers that will have to calculate an amount based on approximately 7,400 local and 45 state tax jurisdictions and remit accordingly, while bricks-and-mortar retailers continue to tax at the point of sale. Imagine requiring every clerk behind a counter to ask their customers to prove where they live and wait around while they calculate the applicable tax rate! That would certainly be fair, but it would also be invasive, inefficient, costly, and irritating for all parties involved.

The tax maze is too complex and varied to burden retailers with remote collection and remittance. Tax cartel proponents argue that simplification will ease this burden, but the "simplified" agreement is still 200 pages long and full of loopholes and exceptions.[11]

Supporters of the legislation also argue that software will make all of the tax calculations, thus sparing businesses the burden of doing so. Unfortunately, this technology will have a cost that most likely will be passed along to consumers. It also raises as many concerns as it purports to resolve. The potential for privacy problems when state and local governments gather this amount of personal information is alarming—especially if they store the information.[12] Handing over all that information to a third party to calculate tax obligations creates another opening for potential security breaches. Putting aside the larger question of whether government should be able to track who buys what, where, and when, the practical potential for identity theft, stolen credit card information, and general embarrassment should give legislators pause.

Businesses will not benefit from S. 1832's brand of fairness—with the exception of a few large online retailers who have already cut rent-seeking incentive deals with states in exchange for collecting and remitting remote taxes. It is not fair to company owners taxed by remote, politically unaccountable authorities who provide them no public services. If someone is going to tax you, shouldn't you at least be able to vote for, or against, them? For businesses that decided to locate in low sales tax jurisdictions, this amounts to changing the rules mid-play. That is not part of anyone's idea of fairness.

The proposed legislation is also unfair in that it creates inequities of taxing authority among states, depending on their degree of compliance with the SSUTA.[13] Full membership allows tax collection on remote sellers and some flexibility with sourcing and exemptions, while partial compliance without full SSUTA membership empowers states to collect on remote sales, but denies them the flexibility full member states will enjoy. States that neither join nor comply with SSUTA will not be able to collect on remote sales, but their businesses (even in sales tax-free states) will be subject to other states remote taxation.

Granting states permission to tax remote sellers also undermines federalism. The Founding Fathers understood that, necessarily, one state's autonomy must end where another's begins. They sought to preserve the beneficial tension between states when they are forced to compete for citizens and commerce. For this reason, they granted Congress authority to protect the free flow of interstate commerce. The proposed legislation's request for Congress' blessing of interstate tax collusion flies in the face of this principle of competitive federalism. We have seen what happens when states' rights include protectionism and discrimination against out-of-state entities; it was called the Articles of Confederation, and we all know how that ended. The SSUTA's vagueness in how auditing and court jurisdiction would work will result in further questions of state sovereignty.

An Origin-Based Alternative. If Congress intends to tackle Internet sales tax policy as part of broader tax reform efforts, it should consider an origin-based tax regime, where the tax rate is assessed for the vendor's principal place of business instead of the buyer's location. An origin-based approach will address the problems of the current system and avoid the drawbacks of S. 1832 and the SSUTA plan by treating all retailers the same and helping preserve federalism, tax competition, political accountability, and consumer privacy.

Here is how our same online book purchase example would look under an origin-based regime: Regardless of whether the Oklahoma retailer has a store or warehouse in Virginia, the purchase will incur Oklahoma sales tax and perhaps any local taxes on where the bookseller is located. The retailer will remit the sales tax to his tax jurisdiction only.

- *An origin-based approach would address the "fairness" issue by treat all retailers the same.* For walk-in stores sales tax is calculated at the point of sale, not by the residency of the customer—who may be crossing state lines or city limits for better deals or tourism. Expanding this origin-based principle to all retailers will ensure that online, catalogue, phone, and yet-to-be-invented sales platforms all will be treated the same as purchases on Main Street.
- *An origin-based system would help preserve federalism and put downward pressure on taxes.* It would allow customers to "vote with their wallets" and gravitate towards lower tax-rate jurisdictions when shopping online or by mail. Citizens benefit when states and localities are free to act as policy laboratories, not when they are forced into a one-size-fits-all national scheme like the one S. 1832 would create.
- *The accounting burden would be minimal.* Retailers of every sort would only have to calculate and remit the taxes applicable to their primary place of business. Their rate and base stays constant whether they sell an item in the store or mail it across the country. This efficiency benefits the economy at large (with the possible exception of sales tax software companies).
- *An origin-based regime preserves consumer privacy.* The tax calculations are based on the seller's location only, so there is no need to collect, store, or share any location information of the buyer. No databases to fill or maintain, no third parties to calculate rates and no audits to verify accuracy are needed under an origin-based approach.
- *An origin-based sales tax keeps political authorities accountable to those they tax, namely, businesses in their own jurisdictions.* This is an especially important consideration for the maintenance of democratic governance. It is simply too easy to tax those who lack a political voice. Therefore, it should be avoided at all costs.

Conclusion. The tax-cartel approach in S. 1832 raises the question: Fairness at what cost? Sacrificing the principles of "no taxation without representation," healthy state and local tax competition, consumer privacy, and economic efficiency is too high a price to pay in order to boost state revenues and appease the special interest group of bricks-and-mortar sellers.

Moreover, it is unnecessary, as there is an alternative approach that brings equity among retailers and preserves the benefits of the current system. If Congress is to act, it should exercise its authority over interstate commerce to produce legislation that fundamentally reforms sales taxes by shifting to an origin-based regime.

Notes

[1] Marketplace Fairness Act (S. 1832), 112th Congress, 1st Session, *http://www.gpo.gov/fdsys/pkg/BILLS-112s1832is/pdf/BILLS-112s1832is.pdf.*

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[5] Streamlines Sales Tax Governing Board, Inc., *Streamlines Sales Tax Agreement* (SSUTA), *http://www.streamlinedsalestax.org/index.php?page=modules.*

[6] SSUTA, Sec. 102.

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[11] SSUTA.

[12] See Daniel Mitchell, "Should You Pay Sales Tax on Amazon?" *The New York Times,* July 29, 2011, available at *http://www.cato.org/publications/commentary/should-you-pay-sales-tax-amazon.*

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Mercatus on Policy—No. 98, October 2011—Mercatus Center, George Mason University

THE INTERNET, SALES TAXES, & TAX COMPETITION

By Veronique de Rugy and Adam Thierer

With most state lawmakers facing large budget deficits, they have become more aggressive about collecting online sales taxes. And now, Congress is considering blessing a multistate compact that would permit states to impose such taxes on interstate commerce, ending a 15-year long debate. To that end, Senator Dick Durbin (D–IL) recently introduced S. 1452, "The Main Street Fairness Act," which would force retailers to collect sales tax for states that join a formal tax compact.[1]

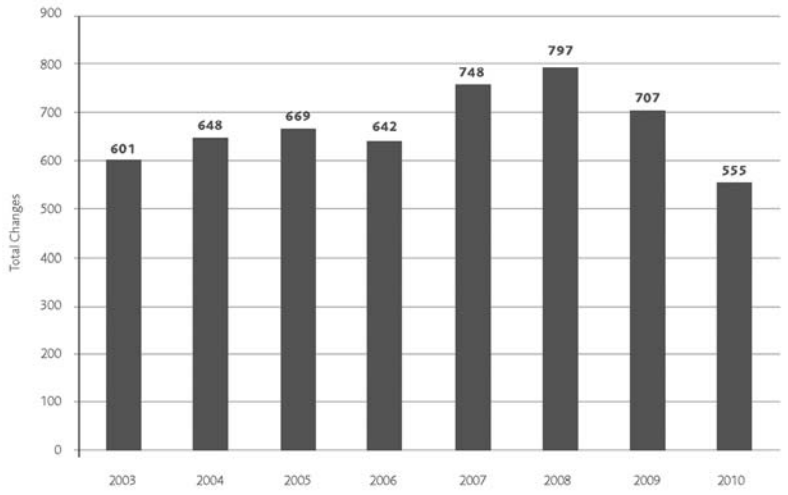
Apart from getting chronic state overspending under control,[2] a better solution to the states' fiscal problems than a tax cartel that imposes burdensome tax collection obligations on out-of-state vendors would be tax competition.[3] Congress should adopt an "origin-based" sourcing rule for any states seeking to impose sales tax collection obligations on interstate vendors. This rule would be in line with Constitutional protections for interstate commerce, allow for the continued growth of the digital economy, and ensure excessive, inefficient taxes do not burden companies and consumers.

Background

While the United States does not have a national sales tax, 45 states and approximately 7,400 local jurisdictions impose sales taxes. State and local governments have the power to require retailers within their borders to collect these consumption taxes at the point of sale in the government's name, but they do not have the authority to require businesses outside of their jurisdictions to collect taxes for them.

Starting in the 1960s, a string of Supreme Court decisions restricted state efforts to impose tax collection requirements on interstate, or "remote," mail order and catalog vendors.[4] The Court held that states could only require firms with a physical presence—or "nexus"—in their jurisdictions to collect sales taxes on their behalf. Applying the timeless principle of "no taxation without representation," these rulings extended sensible Commerce Clause protections to interstate activities. In addition, the Court has ruled that the complexity of state sales tax laws represents an undue burden on interstate commerce because it would be too difficult for out-of-state vendors to comply with those 7,400 local tax systems.[5]

Figure 1: Sales Tax Rate Changes, 2003–2010



Source: Vertex Inc., Berwyn, PA, *vertexinc.com*

Though the Court will not let the states collect taxes from out-of-state sellers, it will let them tax in-state buyers through "use taxes." But, because few people voluntarily compute and pay use taxes,[6] states want online retailers to collect the taxes. States then have turned to counting in-state "affiliates" of online retailers as a sufficient nexus to impose sales-tax collection obligations, arguing that the presence of

an affiliate in a state is sufficient cause for an Internet company to collect the sales taxes for that state.[7]

Companies, however, are as eager to avoid taxes as states are to impose them. In states that have imposed affiliate taxes, online vendors have canceled commission arrangements, destroying in-state jobs and tax *revenues. Amazon.com* and *Overstock.com* recently cancelled affiliate contracts in Connecticut and California, for example, and Amazon has threatened to cut ties with other states. Amazon is also negotiating with states where it has a nexus, such as Texas and South Carolina, for tax-exempt status in exchange for the promise of jobs and investment in those states.[8] If Amazon succeeds in its negotiation, the resulting agreements would not only give the company special treatment compared to other businesses, but it would also would create a vicious cycle in which large companies could get "tax-free" treatment in exchange for promises of jobs, while medium-sized to smaller companies would bear the heavy burden of tax compliance.

Complicated "Simplification"

States are now attempting to circumvent Supreme Court rulings through the "Streamlined Sales and Use Tax Agreement" (SSUTA).[9] The SSUTA seeks to minimize the burden associated with multiple sales tax rates and definitions and, in the process, overcome the constitutional prohibition on the taxation of remote vendors.

Different definitions and exemptions greatly complicate the sales tax codes, as do constant revisions to the sales tax rates (see Figure 1). For example, is a cookie a "candy," which is taxed in most jurisdictions, or a "baked good," which is typically tax-exempt? What type of clothing is "essential" and, therefore, untaxed? When should sales tax holidays be allowed and for what goods? The SSUTA is a good-faith effort to answer such questions. However, the latest incarnation of this constantly changing "simplification" effort runs over 200 pages. Even if states adopted SSUTA, the sales tax base would remain riddled with definitional loopholes and complexities that could burden vendors, especially mom-and-pop operators.[10]

A 2006 PricewaterhouseCoopers study found that sales tax compliance costs for small retailers (with less than $1 million in sales) equaled almost 17 cents of every dollar they collected for states.[11] Expanded tax collection obligations could increase that economic burden and discourage marketplace innovation and new entry. To remedy that, states have considered a "small seller" exemption, but piling exemption on exemption would undermine the goal of simplifying the sales tax system.

Nonetheless, 24 states already have signed on to the SSUTA. It is unclear whether all states will join the effort, meaning complexity will persist if multiple tax rules remain in place. If all states did join the effort, however, it would be the equivalent of a de facto national sales tax system, led by the states. It would discourage beneficial tax competition among governments and likely lead to increased taxes for consumers.

On "Fairness"

States insist the SSUTA is needed to "level the playing field" between online and main street retailers. "Main Street" vendors—whether the mom-and-pop retailers or larger companies, such as Walmart or Target—are clearly burdened with significant tax collection responsibilities. The difference in tax treatment is what animates Senator Durbin's "Main Street Fairness Act."

But fairness cuts many ways. Requiring out-of-state vendors to collect sales taxes on behalf of jurisdictions where they have no physical presence remains unfair and unconstitutional, especially when there are other ways states could promote fairness. One way to level the playing field would be to cut or eliminate sales taxes on in-state vendors. Another alternative would be a national Internet sales tax that would avoid the complexity problem by imposing a single rate and set of definitions on all vendors. But that solution opens the door to a new Federal tax base, which would grow to be burdensome in other ways at a time when American consumers and companies are already over-taxed.

The third and best option might be to clarify tax sourcing rules by implementing an "origin-based" tax system. In this system, states would tax all sales inside their borders equally, regardless of the buyer's residence or the ultimate location of consumption. Under that model, all sales would be "sourced" to the seller's principal place of business and taxed accordingly.

This is, after all, how sales taxes have traditionally worked. A Washington, DC, resident who buys a televison in Virginia, for instance, is taxed at the origin of sale in Virginia regardless of whether he brings the television back into the District. Each day in America, there are millions of cross-border transactions that are taxed only at the origin of the sale; no questions are asked about where the buyer will consume the good. Policy makers should extend the same principle to cross-border

sales involving mail order and the Internet. Under this approach, Internet shoppers would pay the sales tax of the state where the online retailer is based.

An origin-based sourcing rule would have many advantages over the "destination-based" sourcing rule that state officials are pushing. It would eliminate constitutional concerns because only companies within a state or local government's borders would be taxed. An origin-based system would do away with the need for prohibitively complex multistate collection arrangements such as the SSUTA because states would tax transactions at the source, not at the final point of consumption.

An origin-based system also would protect buyers' privacy rights, eliminating the need to collect any special or unique information about a buyer and to use third-party tax collectors to gather such information. Additionally, it would also preserve local jurisdictional tax authority whereas a harmonization proposal like the SSUTA plans would create a de facto national sales tax system that would exclude local governments.

> Apart from getting chronic state overspending under control, a better solution to the states' fiscal problems than a tax cartel that imposes burdensome tax collection obligations on out-of-state vendors would be tax competition.

Finally, because it is more politically and constitutionally feasible, an origin tax may actually maximize the amount of tax collected for states by making compliance easier and incorporating currently untaxed activities.

Conclusion

If Congress feels the need to take action on this front, it should implement an origin-based sourcing rule for the taxation of interstate commerce and make it clear to the states that they are free to impose sales tax on vendors whose principle place of business is within their borders, but not on imports from other states. State officials might protest the vigorous tax competition such a sourcing rule would spawn since some companies might locate their business in more hospitable tax environments. But that is real federalism at work. Federal lawmakers should favor it over tax cartels.

Endnotes

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6. Nina Manzi, "Use Tax Collection on Income Tax Returns in Other States," Policy Brief Research Department, Minnesota House of Representatives, June 2010, *http://www.house.leg.state.mn.us/hrd/pubs/usetax.pdf.*

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promoting Amazon products on their sites. See Justin Pratt, "On Sales and Use Tax, Nexus and Affiliates," *Mobile Evolution,* July 10, 2011, *http://creativealgorithms.com/blog/ content/sales-and-use-tax-nexus-and-affiliates.*

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11. PricewaterhouseCoopers, *Retail Sales Tax Compliance Costs: A National Estimate,* Joint Cost of Collection Study, April 7, 2006, *http://www.bacssuta.org/Cost%20of%20Collection%20 Study%20-%20SSTP.pdf.*

The Mercatus Center at George Mason University is a research, education, and outreach organization that works with scholars, policy experts, and government officials to connect academic learning and real world practice.

The mission of Mercatus is to promote sound inter disciplinary research and application in the humane sciences that integrates theory and practice to produce solutions that advance in a sustainable way a free, prosperous, and civil society.

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July 19, 2012—*Policy Tip Sheet*

MYTH VS. FACT—INTERNET TAXES

Myth 1: A tax on Internet sales just enables states to collect taxes they are already legally entitled to collect.

Fact: A state is not legally entitled to collect taxes from Internet sellers with no physical presence in that state.

In *Quill Corp.* v. *North Dakota,* the U.S. Supreme Court ruled in 1992 that a mail-order or Internet business must have a physical presence in a state for that state to require it to collect sales or use taxes, affirming the ruling in a 1967 case. While individuals may be legally obligated to report purchases they make out-of-state or from online sellers and then pay a "use" tax to the taxing jurisdiction in which they live, the Supreme Court has said states legally cannot compel out-of-state businesses to collect and pay such taxes to states where the sellers have no physical presence.

More than 9,600 government units levy sales taxes, making compliance with an Internet sales tax incredibly difficult. For each state in which a business has a physical presence, a business already needs to collect accurate information on a buyer's home or place of business, access online databases to calculate the tax due, collect the tax, and then arrange for it to be sent to the taxing body. North Dakota argued for a flexible test under which sellers with certain contacts with a state or buyers residing in that state (though lacking physical presence in it) would also be required to collect and pay the tax. The Supreme Court recognized this burden was unreasonable.

Myth 2: An Internet tax would level the playing field between online and bricks-and-mortar businesses.

Fact: A new tax is not necessary to "level the playing field," and in fact introduces new distortions and unfairness.

Businesses that maintain bricks-and-mortar stores are free to sell their products online, and in fact many or most do. So if the playing field isn't already level, a

retailer can make it so by launching a website. A tax on Internet sales is really just a subsidy to businesses that refuse to make the transition to a blended retail model of bricks-and-mortar store with Internet sales.

Local businesses benefit from federal, state, and local expenditures related to a business district, including roads, water, sewers, lights, and police and fire protection. The taxes they pay go to pay for those services, and arguably are the price of those services. The only cost an out-of-state Internet seller imposes is the use of roads by a FedEx or UPS truck delivering the product from a warehouse to a customer's home. UPS and FedEx pay hundreds of millions of dollars a year in motor fuel taxes to pay for roads.

The current arrangement, in short, accurately allocates the responsibility to collect taxes to the use of public services.

Myth 3: Compliance will be easy and inexpensive due to software.

Fact: The cost of compliance would be unduly burdensome for small businesses despite advances in software.

Currently there are more than 9,600 state and local sales tax jurisdictions in the United States. An Internet sales tax would require online retailers to comply with the detailed, conflicting, ever-changing, and often-ambiguous requirements of those 9,600 taxing jurisdictions. A 2006 *PricewaterhouseCoopers study* found small retailers (less than $1 million in sales) already have compliance costs of 17 cents for every dollar they collect in tax revenue for states.

Mail and Internet use allow even the smallest businesses to sell their products or services all over the country, giving them enormous opportunities to expand their reach and grow while at the same time giving customers the greater choice and cheaper prices increased market competition provides. With increased compliance costs and liability risks, small businesses and entrepreneurs are less likely to expand their reach into other states.

Myth 4: States are missing out on a massive amount of revenue.

Fact: This tax would kill jobs and not be the revenue windfall advocates are claiming.

The total potential uncollected sales tax revenues in 2008 would have been "less than three-tenths of one percent of state and local tax revenues," *according to a study* by Jeffrey A. Eisenach, an adjunct professor at George Mason University Law School, and Dr. Robert Litan, a senior fellow at The Brookings Institution.

To date very little revenue has been actually collected in states that have passed so-called "Amazon taxes." Revenues from Internet taxes are likely to be curbed from economic losses as a result of small businesses and affiliate programs being no longer able to compete.

According to the *Tax Foundation,* "Contrary to the claims of supporters, Amazon taxes do not provide easy revenue. In fact, the Nation's first few Amazon taxes have not produced any revenue at all, and there is some evidence of lost revenue. For instance, Rhode Island has seen no additional sales tax revenue from its Amazon tax, and because Amazon reacted by discontinuing its affiliate program, Rhode Islanders are earning less income and paying less income tax."

Myth 5: The taxing powers offered by the Marketplace Fairness Act (MFA) are limited in scope.

Fact: The MFA would open the door to state taxes on digital products, such as iTunes, and on other transactions outside their borders.

Allowing states to collect taxes on transactions occurring outside their borders is fundamentally unfair and threatens basic economic liberties. The persons paying and collecting the taxes do not have an opportunity to vote or otherwise participate in the government process that creates the tax or sets its rate. This "taxation without representation" is compounded by the fact that those paying the taxes receive no public goods or services in return for their payment—"taxation without benefits." The incentive structure created by allowing such taxation will lead to ever-rising taxes and government spending, since the victims have no way to vote against higher taxes.

Once the online sale of real goods is taxed, it will be only a matter of time before digital products, such as iTunes, apps, ring-tones, digital books, and movies will also be taxed. States will see the Internet as a practically unlimited source of tax income by charging low rates on large numbers of transactions.

According to a study by the *Mercatus Center,* "Requiring out-of-state vendors to collect sales taxes on behalf of jurisdictions where they have no physical presence remains unfair and unconstitutional, especially when there are other ways states

could promote fairness. One way to level the playing field would be to cut or eliminate sales taxes on in-state vendors. Another alternative would be a national Internet sales tax that would avoid the complexity problem by imposing a single rate and set of definitions on all vendors. But that solution opens the door to a new Federal tax base, which would grow to be burdensome in other ways at a time when American consumers and companies are already over-taxed."

Conclusion

An origin-based tax system for online purchases is simpler and more taxpayer-friendly than a destination-based tax system.

In a destination-based tax system, a customer is charged at the rate where the customer is located or is expected to use the product. The increase in the number of intangible services and property sold over the Internet makes it extremely difficult to determine where the product will be used, since computer programs and digital property such as music files can be downloaded all over the country.

There are three problems with a destination-based tax on the Internet. Tax competition among the states would be hindered, it would undercut federalism, and it would push tax rates up.

In comparison, states currently tax sales using an origin-based tax system. A consumer buys a product in a store or from a remote business, and he or she is taxed at the rate where the business is physically located.

So while destination-based taxation requires reporting to multiple governmental jurisdictions and creating substantial business costs for small start-up companies and Internet entrepreneurs, origin-based taxation would foster competition among the states and would be simpler for businesses to comply with.

Nothing in this report is intended to influence the passage of legislation, and it does not necessarily represent the views of The Heartland Institute. If you have any questions about this issue or The Heartland Institute, contact Heartland Government Relations Director John Nothdurft at 312/377–4000 or *jnothdurft @heartland.org*.

Empiris LLC—February 2010

UNCOLLECTED SALES TAXES ON ELECTRONIC COMMERCE: A REALITY CHECK

Jeffrey A. Eisenach and Robert E. Litan †

Executive Summary

Under the Supreme Court's 1992 *Quill* decision, online retailers are not required to collect sales taxes in states where they do not have a physical presence, or "nexus." As a result, state and local sales taxes are not collected on some proportion of interstate sales. Since the early days of the Internet, state and local governments have lobbied Congress to overturn *Quill* and force e-retailers to collect taxes on all sales, regardless of whether they have nexus.

The amount of uncollected taxes involved is central to the debate. Overturning *Quill* would impose significant administrative costs, especially on small businesses (where administrative costs account for as much as 13.5 percent of taxes collected), and would have other negative consequences as well. If, the resulting tax collections would be too small to materially affect state and local government finances, then governments arguably should look elsewhere for a solution to their fiscal difficulties.

In this study, we present an estimate of the amount of potential uncollected sales tax revenues for 2008, and a forecast of uncollected revenues through 2012. Our primary findings are:

- Total potential uncollected sales tax revenues in 2008 were approximately $3.9 billion, or less than three-tenths of one percent of state and local tax revenues.
- More than one third of uncollected revenues are associated with small businesses. If firms with less than $5 million in remote sales were exempt (as proposed by legislation introduced in recent Congresses), potential uncollected reve-

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† The authors are, respectively, Chairman, Empiris LLC and Adjunct Professor, George Mason University School of Law; and Senior Fellow, Economic Studies and Global Economics Programs, The Brookings Institution and Vice President, Research and Policy, The Kauffman Foundation. We are grateful to Allan Ingraham, Robert Kulick, Molly Wells and Billy Schwartz for assistance, though any errors or omissions are our own. The views here are those of the authors, and should not be attributed to any of the institutions with which they are affiliated, or to the trustees, officers, or employees of those institutions. Support for this study was provided by NetChoice.

nues fall to approximately $2.45 billion, or less than two-tenths of one percent of state and local tax revenues.

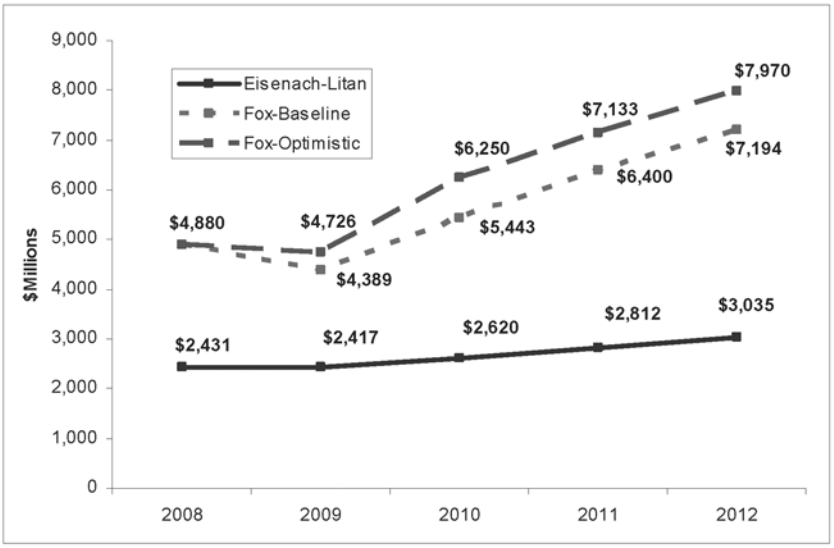
- Uncollected revenues are not rising rapidly. Uncollected revenues (from firms with more than $5 million in remote sales) will average approximately $2.67 billion over the 2008–2012 period, or about two tenths of one percent of total state and local tax revenues.
- The growth of "brick and click" retailing (*i.e.,* brick and mortar retailers with substantial online sales) is likely to reduce the proportion of online sales on which taxes are not collected. In addition, states are using various tactics to promote tax collection by "out-of-state" firms. These two trends suggest that uncollected revenues are likely to fall over time—*i.e.,* that the uncollected revenue problem is "solving itself."
- A few large firms account for the bulk of uncollected tax revenues. For example, the top 10 firms (ranked by uncollected taxes) account for approximately 47 percent of total uncollected revenues. This finding provides some support for those who have argued that the states should focus their efforts on firms with large uncollected tax revenues.

Our findings differ markedly from those of a recent study by a group at the University of Tennessee (the *Fox Study*), which estimated uncollected tax revenues associated with *Quill* at over $7.7 billion in 2008, rising to as much as $12.7 billion in 2012. The differences can be attributed to three primary factors:

- First, the *Fox Study* substantially overstates uncollected taxes associated with business-to-business (B2B) online sales.
- Second, the *Fox Study* understates tax collections by small firms.
- Third, with respect to "out-year" projections, the *Fox Study* assumes an unrealistically high and unsustainable growth rate for online sales, especially considering the fact that the growth of broadband penetration among U.S. households—one of the primary drivers of online sales growth—is slowing as household broadband penetration approaches saturation.

The differences between our results and those of the *Fox Study* are summarized in the figure below. In our view, the most significant difference is in the rates of growth: Rather than growing rapidly, as the *Fox Study* suggests, our analysis demonstrates that uncollected revenues are, at most, growing slowly. Given that uncollected revenues account for such a small proportion of revenues, our assessment is that state and local tax collectors would be best served by focusing their efforts on other potential revenue sources.

Potential Uncollected Revenue Forecasts, 2008–2012



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Appendix: State-by-State Estimates of Potential Uncollected Revenue

I. Introduction

In its 1992 *Quill* decision,[1] the Supreme Court affirmed prior holdings that state sales tax regimes were so complex that forcing out-of-state firms to collect taxes would present an unreasonable burden on interstate commerce. Consequently, the court ruled that retailers could not be forced to collect sales taxes for states where they do not have a physical presence, or "nexus." While states also require buyers to pay "use taxes" in lieu of unpaid sales taxes, and businesses generally do so, use tax compliance is generally agreed to be relatively low among consumers. As a result, states and localities have long complained that the growth of e-commerce—a portion of which is comprised of remote sales—is depriving them of significant tax revenues, and have sought legislation that would overturn *Quill* and force online retailers to collect and remit state and local sales taxes on remote sales. Retailers, on the other hand, argue that the administrative costs of collecting taxes for several thousand state and local sales tax jurisdictions would be overly burdensome, especially for small businesses that likely have *de minimis* sales in many states.

Whether it makes sense to overturn *Quill* depends in part on how much additional tax revenue would actually be generated. If the potential increase in tax revenues is sufficiently large, some would argue that it would be worthwhile to incur the administrative costs (both public and private) required for collection; otherwise, the government should look elsewhere for revenue sources that involve lower welfare costs to society (as a share of taxes collected).[2]

Several studies have attempted to estimate the magnitude of uncollected sales taxes associated with out-of-state online sales. The most widely cited analysis, by Donald Bruce, William F. Fox, and LeAnn Luna at the University of Tennessee (the "*Fox Study*"), estimates that state and local governments will fail to collect between $44.8 billion and $49.1 billion in tax revenues on online sales over the five-year period between 2008 and 2012.[3] While these estimates are still quite low as a proportion of total state and local tax revenues (about 0.6 percent), or even state and local sales tax revenues (about 2.5 percent),[4] they are sufficiently large that states and localities have cited them in support of their efforts to promote Federal legislation. Other analysts have suggested these estimates are too high, that the actual amount of tax revenues foregone is much lower, and that the amount of additional taxes that might plausibly be collected is lower still, especially since Congressional pro-

[1] 504 U.S. 298, 112 S.Ct. 1904.

[2] Of course, administrative costs are not the only consideration. In general, the most efficient taxes are those which generate the lowest deadweight losses, including the costs of economic distortions as well as administrative costs. See *e.g.,* Edgar K. Browning and Jacqueline M. Browning, *Public Finance and the Price System* (New York: MacMillan Publishing, 1979) at 288–294.

[3] Donald Bruce, William F. Fox, and LeAnn Luna, *State and Local Government Sales Tax Revenue Losses from Electronic Commerce, University of Tennessee Working Paper* (April 13, 2009) (hereafter *Fox Study*).

[4] For example, the *Fox Study* estimates uncollected revenues of $7.26 billion in 2008. The Census Bureau reports total state and local tax revenues for the 12 months ended December 2008 were $1.304 trillion, and state and local sales and gross receipts taxes for this period were $305 billion. See U.S. Census Bureau, Federal, State and Local Governments: Quarterly Summary of State and Local Government Tax Revenue (*http://www.census.gov/govs/www/qtax.html,* viewed August 31, 2009).

posals to mandate collection of remote sales tax have exempted small business retailers.[5]

In this study, we provide estimates of the potential state and local sales tax revenues from Internet retailers, using data from a range of sources, including a recent comprehensive survey of retailers doing business both on and off the Net (both pure Net retailers and those using the "bricks and clicks" model). Our estimates of lost revenue are far lower than those in the *Fox Study*—at $3.9 billion for 2008, slightly more than half. Moreover, assuming—as seemsextremely likely—that a sales tax collection mandate would include an exemption for small businesses, the amount would be even less: Approximately $2.4 billion, or *less than two-tenths of one percent* of state and local government tax revenues. In the balance of this introductory section we explain why our estimates differ from the *Fox Study,* and in the rest of the paper, we provide the details.

The amount of revenue that would be generated by a mandate to collect remote sales tax depends on three primary factors: (1) The dollar amount of taxable e-commerce sales on which taxes currently are due, but not collected; (2) the applicable tax rates on these sales; and, (3) the "reach" of the mandate, *i.e.,* the revenues that would be exempted if, for example, small businesses were not covered (or, realistically, if there was a significant amount of noncompliance). Unfortunately, none of these three magnitudes is directly observable, and it is therefore necessary to develop estimates. For example, while there are both public and private estimates of the total amount of retail online sales, it is necessary to estimate the proportion of these sales accounted for by products (*e.g.,* food products, intangibles) that are exempt from state and local sales taxes. Of the remainder, it is necessary to estimate the proportion of sales for which taxes are already collected, either because they are made to customers in states where the seller has nexus, or because the buyer pays use taxes, which is typical for most business-to-business (B2B) sales. Once an estimate of untaxed sales is developed, the overall sales figure must be allocated across jurisdictions in order to apply the appropriate tax rates. Finally, in order to make going-forward projections of lost tax revenues, it is necessary forecast the key underlying variables for future periods.

In this study, we utilize data from a variety of sources to estimate the amount of uncollected sales taxes on electronic sales for 2008–2012. The starting point for our analysis is a survey of sales tax collection practices of the largest online retailers as reported by *Internet Retailer,* which reports annual online sales revenues for the 500 largest Internet retailers, including both "pure play" online retailers (like *Amazon.com*) and "brick-and-click" or "multichannel" retailers (like Target and Wal-Mart). To ascertain the extent to which these firms collect sales taxes on online sales, we went beyond the data in the *Internet Retailer* report to survey the sales tax collection practices of 250 firms (including the top 150, the bottom 50 firms and 50 from the "middle" of the distribution) to ascertain the states in which sales taxes are already collected on online sales by the top 500 firms. We also develop estimates for uncollected taxes by smaller firms, which represent about $28 billion, or 21 percent, of 2008 online sales. Finally, we also forecast online sales and uncollected revenues for the five-year period 2008–2012.

As indicated, we estimate that uncollected sales taxes on state and local sales in 2008 totaled approximately $3.9 billion, slightly more than half of what is estimated by the *Fox Study.* Over the course of the five-year period from 2008–2012, our estimates diverge still further from those of the *Fox Study.* For example, the *Fox Study* estimates uncollected revenues could be as high as $12.7 billion in 2012, compared with our estimate of $4.7 billion. As we explain below, there are three major reasons for the differences between our estimates and those of the *Fox Study:* First, the *Fox Study* substantially overstates uncollected taxes associated with businessto-business (B2B) online sales; second, the *Fox Study* understates tax collections by small firms; third, with respect to "out-year" projections, the *Fox Study* assumes what we regard as an unrealistically high and unsustainable growth rate for online sales, especially considering the fact that the growth of broadband penetration among U.S. households—one of the primary drivers of online sales growth—is slowing as household broadband penetration approaches saturation.

The remainder of this paper is organized as follows. Section II describes our approach and key assumptions, and describes our data set and survey methodology. Section III presents our results for both the baseline (2008) estimate of uncollected taxes and our five-year (2008–2012) forecast. Section IV puts our results in context

[5] See, *e.g.,* Billy Hamilton, "Internet Sales Tax: What If There's No There There," *State Tax Notes* 49 (September 1, 2008) at 627 and Peter A. Johnson, *Setting the Record Straight: The Modest Effect of Ecommerce on State and Local Sales Tax Collection* (Direct Marketing Association, January 19, 2008).

and briefly discusses policy implications. Section V presents a brief summary of our findings.

II. Data, Methodology and Assumptions

Our central objective is to estimate the amount of online retail sales made by firms in states where they are not required to collect sales taxes, and then to estimate the taxes not being collected on those sales. To do so, we begin by establishing the size of the overall tax base (*i.e.,* the universe of taxable online sales). Next, we estimate the proportion of sales that occur in states where the seller lacks nexus (and therefore is assumed not to collect sales taxes). Third, we distribute these sales across states, and multiply by the appropriate tax rates. In this section, we describe the data, methodology and assumptions we used in conducting each step. Where appropriate, we note where our approach differs from that adopted in the *Fox Study* and explain why we believe our approach is more appropriate for evaluating alternative sales tax policies.

A. Estimating the Tax Base

Our first step is to estimate total retail e-commerce sales which are subject to state and local sales and use taxes. The authoritative source of such data is the U.S. Census Bureau, which conducts both monthly and annual surveys of retail trade and, on the basis of those surveys, reports retail e-commerce on both a quarterly and annual basis. Quarterly reports are based on the Monthly Retail Trade Survey (MRTS), and annual reports are based on the Annual Retail Trade Survey (ARTS).[6] While the Census publishes separate estimates for B2B and B2C e-commerce, its B2C estimates in fact count *all* retail e-commerce, including retail e-commerce involving sales from one business to another.[7] The Census online sales data are also comprehensive with respect to types of sellers, as they include "catalog and mail order operations, many of which sell through multiple channels; "pure plays" (*i.e.,* retail businesses selling solely over the Internet); and e-commerce units of traditional brick-and-mortar retailers (*i.e.,* 'brick and click')."[8] Thus, we believe the Census Bureau data represents the best estimate of the total amount of e-commerce potentially subject to sales tax, although, as we explain below, there are some reasons to believe it represents an overestimate of the overall tax base. Table 1 below shows the Census Bureau's estimates of retail e-commerce from 1999 through the second quarter of 2009.

Table 1.—Retail E-Commerce 1999–2009

[$ billions]

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008*	2009**
E-Retail Sales	$15	$28	$34	$45	$57	$76	$87	$107	$127	$133	$128
% of Total Retail	0.5%	0.9%	1.1%	1.4%	1.8%	2.2%	2.4%	2.8%	3.2%	3.4%	3.6%
YOY % Change	—	86.7%	21.4%	32.4%	26.7%	33.3%	14.5%	23.0%	18.7%	4.7%	–3.8%

Source: U.S. Census Bureau/E-Stats
** Based on most recent revised quarterly reports.*
*** Annual rate based on Q1, Q2.*

Our estimate of retail e-commerce differs from the one advanced by the *Fox Study,* which takes a very different approach. For reasons which are not apparent (given that the Census Bureau retail sales data include B2B as well as B2C sales), the *Fox Study* begins by including all e-commerce sales, *including sales classified by the Census Bureau as B2B sales.* These sales have little or no potential for uncollected sales tax, for two reasons: First, wholesale sales or "inputs-to-production" generally are exempt from sales and use taxes.[9] Second, even if some retail sales are captured in the Census Bureau's B2B category, nearly all businesses file and

[6] See *http://www.census.gov/retail/mrts/www/data/pdf/09Q2.pdf* and *http://www.census.gov/econ/estats/2007/2007reportfinal.pdf.*

[7] See *http://www.census.gov/econ/estats/2007/2007reportfinal.pdf* at 2 ("We estimate business-to-business (B-to-B) and business-to-consumer (B-to-C) e-commerce by making several simplifying assumptions: manufacturing and wholesale e-commerce is entirely B-to-B, *and retail and service e-commerce is entirely B-to-C.*")

[8] *http://www.census.gov/econ/estats/2007/2007reportfinal.pdf* at 3.

[9] For example, the Census Bureau's definition of "wholesale" establishments clearly excludes retailers, yet the *Fox Study* includes sales by such establishments in the tax base for retail commerce. See U.S. Census Bureau, 2002 NAICS Definitions, 42 Wholesale Trade (at *http://www.census.gov/epcd/naics02/def/NDEF42.HTM).*

pay the use tax due on their retail purchases, largely because state tax auditors can readily close use tax compliance gaps by examining business records.

Recognizing that its approach is over-inclusive, the *Fox Study* next attempts to exclude some B2B sales, based in part on a survey the authors conducted of state sales tax personnel, who were asked to estimate the proportion of various categories of B2B sales which might be subject to sales tax. Having conducted the survey, however, the *Fox Study* concludes that the results are unreliable, and discards many of the responses in favor of *ad hoc* corrections based on a subset of the data which more closely match the authors' *a priori* expectations.

The ultimate effect of the *Fox Study's* approach is to inflate the taxable base by including a substantial amount of B2B sales which are not subject to sales and use taxes, and then to apply an *ad hoc* and arbitrary approach to correcting the error.[10] In our view, the entire exercise is both unnecessary and inappropriate: While the Census Bureau data are labeled "B2C," they in fact include *all* retail sales, that is, all sales that are potentially subject to state and local sales and use taxes. There is no valid basis for adding in additional B2B sales.

In fact, there at least three good reasons for believing the Census Bureau retail e-commerce estimates are over-inclusive with respect to taxable sales, even without adding in additional B2B sales. First, the Census Bureau's retail e-commerce data include sales by motor vehicle and parts dealers, which comprise 19 percent ($24 billion in 2007) of total retail e-commerce. Including these sales in the total likely overstates the potential tax base both because automobile sales—regardless of how they are conducted—are subject to taxation at the time of registration, and because many sales of automobile parts are likely B2B sales which are not subject to sales or use taxes in the first instance.

Second, while the Census Bureau data exclude online travel services, financial brokers and ticket sales agencies, they include sales of at least three types of items—food, clothing, and intangibles (*e.g.,* downloaded software,)—which often are not subject to sales tax. The *Fox Study* attempts, through its survey of state finance department personnel, to estimate the proportion of B2C sales that are subject to taxation, and ultimately concludes that about 30 percent of B2C sales are exempt from sales and use taxes. While we agree that many B2C sales are not taxable, we do not believe the *Fox Study's* survey results are sufficiently reliable to form the basis for such a precise estimate.

Third, to the extent the Census Bureau data include B2B sales, it is likely that the purchasing businesses pay use taxes on purchases for which sales tax is not collected by the seller. Past research suggests that the use tax compliance rate among businesses is between 85 and 100 percent.[11]

We considered various approaches to adjusting for these issues of over-inclusion, including—for example—excluding e-commerce sales by automobile dealers, supermarkets andonline music services), but we ultimately chose not to make such adjustments because we lack the underlying data needed to do so with precision. As a result, our estimate of the overall retail e-commerce tax base is likely to be significantly above the true amount, meaning that our estimates of uncollected taxes are likely also biased upwards relative to the actual amount.

B. Establishing Nexus

The second step in our analysis is to ascertain the extent to which sales taxes are already being collected on retail e-commerce sales, that is, to determine the extent to which retail e-commerce involves sales to customers in states where the seller has nexus or is, for whatever reason, collecting sales taxes.[12] To do so, we began by researching the firms listed in the 2009 edition of *Internet Retailer Top 500 Guide,* which provides data on 2008 retail e-commerce sales by the largest online retailers, or all those with annual online sales exceeding $9 million.[13] Specifically,

[10] The *Fox Study* does not document the methodology by which it arrives at its baseline estimates of the electronic commerce. Moreover, the study provides only an unlabelled bar graph showing historical electronic commerce data, making it impossible to compare the underlying data used in the study to actual data from the Census Bureau. As a result, it is not possible to estimate the precise amount by which the *Fox Study* overstates the tax base.

[11] *See e.g.,* Johnson at 6.

[12] As we discuss further below, "nexus" is an inexact and evolving concept. For example, New York has recently passed legislation defining nexus as including a situation where an online retailer has sales affiliates in the state (*e.g.,* an Amazon advertisng partner). Amazon has sued the state over this law, and is collecting sales tax on sales to New York residents, pending the outcome of its lawsuit.

[13] Information on the *Guide* is available at *www.internetretailer.com/top500.*

for 250 of the 495 U.S. firms listed in the guide,[14] we ascertained the states in which each firm collected sales taxes on online sales. For each firm, we followed the following sequence: First, we visited the firm's website and searched for a listing of states in which tax was collected; second, if the website data was inconclusive, we contacted the firm's customer service department; third, if customer service was unable or unwilling to provide the information, we researched the firm's website, its Securities and Exchange Commission filings, and other public data, for a list of states in which the firm in has a retail store or other physical presence.[15]

Several findings from this portion of our analysis are worth highlighting. First, there is an extremely wide variance in the number of states where firms collect taxes. For the top 150 *Internet Retailer* firms, for example, 77 collect in 10 states or fewer, and 62 collect in 30 or more; only 11 collect in 11 or more states but fewer than 30. This bi-polar distribution reflects the distinction between "pure play" retailers (such as *Amazon.com*) which have nexus in very few states, and "brick and click" retailers (such as Staples) which collect taxes in most or all states. As shown in Table 2, most of the largest online retailers (ranked by 2008 U.S. online sales) are "brick and click" firms which collect taxes in most or all of the states with sales taxes.

Table 2.—States Where Sales Taxes Are Collected, Top 20 E-Retailers

Firm	2008 Online Sales	States Where Taxes Are Collected
Amazon.com[16]	$10,228,000,000	5
Staples	$7,700,000,000	44
Dell	$4,830,000,000	47
Office Depot	$4,800,000,000	47
Apple	$3,642,118,080	47
OfficeMax	$3,083,730,683	47
Sears Holdings	$2,693,433,600	47
CDW	$2,600,122,100	47
Newegg	$2,100,000,000	3
Best Buy	$2,015,183,282	47
QVC	$1,993,361,800	47
SonyStyle.com	$1,827,577,534	47
Walmart.com	$1,740,000,000	47
Costco	$1,700,000,000	38
J.C. Penney Co.	$1,500,000,000	47
HP Home & Home Office Store	$1,497,000,000	47
Circuit City Stores*	$1,414,000,000	29
Victoria's Secret	$1,333,000,320	45
Target	$1,209,208,320	46
Systemax	$1,072,071,000	5

Source: Internet Retailer
**Circuit City Stores went through Chapter 7 in 2008*
Note: While it does not have a state sales tax, we count Alaska as a sales tax state, given that multiple local jurisdiction levy sales and use taxes.

Second, as shown in Figure 1, the distribution of e-retail sales is heavily skewed towards the largest retailers. Overall, we found that the top 20 Internet retailers accounted for nearly $59 billion in 2008 sales (44 percent of the $133 billion total), and the top 495 firms accounted for approximately $105 billion in sales, or 79 percent of all sales. The remaining retail e-commerce sales ($28 billion) are associated with smaller firms, *i.e.,* those with less than $9 million in online sales.[17]

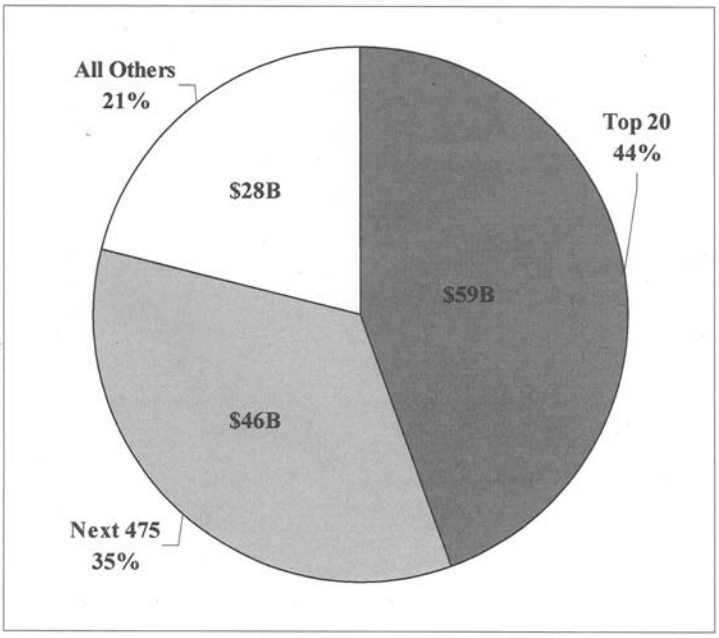
[14] Five firms are Canadian and thus not subject to U.S. sales taxes or included in the U.S. Census Bureau data. Of the remainder, we surveyed each of the top 150 firms and bottom 50 firms, and an additional 50 firms ranked between 150 and 450.

[15] When no determination could be made, we assumed that the firm in question *did not* collect sales taxes in any state. Our approach was similar to that used by the *Fox Study,* though their data was based on the 2007 edition of *Internet Retailer,* and they surveyed only 100 firms (the top 50 plus 50 more chosen at random). See *Fox Study* at 20. Note that, like the Census Bureau data, the *Internet Retailer* guide excludes online travel agents and brokerages, but includes several categories of sellers (*e.g.,* music and game download sites, grocery stores) whose sales are likely largely exempt from sales taxes.

[16] We adjusted Amazon's total sales to reflect the fact that approximately 47 percent of its $19 billion in sales (about $9 billion) are made outside the United States. See *Amazon.Com,* Inc., *Form 10–K for the Fiscal Year Ended December 31, 2008* at 30.

[17] As we discuss further below, the *Fox Study* cites a recent draft working paper which argues that the Census Bureau data underestimates sales by small firms. (*See* Joe Bailey *et. al,* "The Long Tail is Longer than You Think: The Surprisingly Large Extent of Online Sales by Small

Figure 1: Distribution of Retail E-Commerce by Firm Size, 2008



C. Apportioning Sales Among States

Uncollected tax revenues in any given state are the product of online sales in the state upon which taxes are not collected and the applicable tax rate. Thus, the next step in our analysis is to apportion each company's sales among the states. We do so by assuming that individual firm e-commerce revenues are distributed across the 50 U.S. states (and Washington D.C.) in the same proportions as overall 2008 total retail sales, as reported by the Census Bureau. That is, for example, if a particular state accounts for five percent of retail commerce in the United States, we attribute five percent of each firm's online sales to that state.[18]

We considered other approaches to apportioning sales across states. The *Fox Study,* for example, apportions sales on the basis of total state and local sales tax collections, thus weighting sales towards states with higher tax rates. The authors defend this approach on the basis of studies which show that consumers in high tax states are more likely to shop online than consumers in low tax states, presumably to avoid paying sales taxes.[19] One problem with this approach is that tax rates are only one of many factors that affect the geographic distribution of online sales, in-

Volume Sellers," Draft, University of Maryland, May 12, 2008.) While a complete critique of that paper is beyond the scope of this study, it is clear that it suffers from numerous methodological problems which make its results unreliable. (To cite just one example, the Bailey paper relies on comScore data on web sales by the top 140 online retailers (with average annual online sales of *$675 million*) to estimate sales by firms with sales *below $1 million.*) While the *Fox Study* relies on the Bailey paper to estimate the distribution of sales by firm size, it does not embrace the Bailey paper's contention that the Census Bureau underestimates overall e-commerce sales and does not rely on the Bailey paper for its estimate of total online sales.

[18] We deviated from this method in the case of only three firms in our sample: Peapod, Safeway, and FreshDirect. These three firms are brick and click grocers with very specific areas of operations. We contacted these firms and determined the states in which they provide their online grocery service and applied their total online sales, as listed in *Internet Retailer,* only to those states.

[19] See, *e.g.,* Austan Goolsbee, 2000. "In a World Without Borders: The Impact of Taxes on Internet Commerce," *Quarterly Journal of Economics* 115; 2 (May 2000) 561–576.

cluding (for example) the proximity of the retailer to the buyer,[20] and demographic factors such as personal income, Internet penetration and broadband adoption.[21] Thus, while there is some evidence that people in high tax states are more likely to shop online *other things equal,* there is no evidence we are aware of that suggests that differences in tax rates explain a significant portion of the variation in online retail sales across states. Moreover, we suspect one of the strongest determinants of the distribution of firm sales across states is domicile—that is, given the growing significance of "brick and click" retailing, we suspect many retailers' online sales are concentrated in states where customers can visit their affiliated retail stores to preview items and seek the convenience of returning or exchanging items they havepurchased online. This phenomenon which would tend to work against the *Fox Study's* bias of allocating more sale to high-tax states. In the end, rather than introducing spurious (or even biased) variation into our data set (as we believe the approach taken by the *Fox Study* does), we elected to simply apportion online sales according to overall retail sales.

III. Estimates of Uncollected Taxes

The next steps in our analysis are to calculate estimates of uncollected taxes for 2008, based on the estimates of underlying variables discussed above, and then to forecast uncollected taxes into the future, *i.e.,* for the period from 2009–2012.

A. Uncollected Revenues in 2008

To estimate uncollected revenues for 2008, we begin by estimating uncollected revenues for the large firms covered in the *Internet Retailer* report, and then add an estimate for smaller firms (those with revenues below $9 million). We note, however, that the estimate for smaller firms is, in a sense, less significant, as there appears to be general agreement that the administrative costs of collecting from smaller firms is much higher than for larger firms (For example, a survey commissioned by the Streamlined Sales Tax Project found that firms with annual retail sales of between $150,000 and $1 million incur collection costs averaging 13.5 cents for every dollar of sales tax they collect.[22]), and that even if larger firms were to be required to collect taxes on out-of-state sales, smaller firms would be exempted.

To estimate uncollected revenues for large firms, we multiplied state-specific retail e-commerce revenues for each firm by the applicable sales tax rates for each state.[23] Thus, for each firm, we calculated the amount of taxes that would be owed in each state, if the firm had nexus in that state. Next, for each firm, we sum this amount across all states in which the firm does not collect sales taxes. As shown in Table 3 below, the total for the top 150 firms in 2008 was $1.985 billion; for the bottom 50 firms, the total was $27 million. For the middle group of 300 firms, we first calculated the average ratio of taxes collected to potential taxes due for the 50 firms whose tax collection practices we sampled from this group, and applied this ratio to all 300 firms. On that basis, we estimate the total for the 300 middle firms at $418 million.

The last step in our analysis was estimate the ratio of taxes collected to potential taxes for smaller firms, or those not included in the *Internet Retailer 500* survey. As noted above, we estimate these firms constitute approximately 21 percent (or $28 billion in 2008) of retail e-commerce sales.

We considered but rejected the approach adopted in the *Fox Study,* which was to simply assume extremely small tax compliance rates for small firms. Specifically, the *Fox Study* assumes, without any empirical basis, that "medium-sized firms" (those with online revenues of less than $10 million) pay taxes only in their home states, and thus (dividing 1 by 50) the *Fox Study* assigns these firms a two-percent compliance rate—even if their home state is California; and, it assumes that "small" firms (online revenues less than $1 million) only pay half of the taxes due even in their home states (on average), and hence have a compliance rate of one percent.

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[20] See, *e.g.,* Glenn Ellison and Sara Ellison. "Internet Retail Demand: Taxes, Geography, and Online-Offline Competition," (Massachusetts Institute of Technology Department of Economics Working Paper Series, May 2006).

[21] See *e.g.,* John Horrigan, *Online Shopping* (Pew Project on the Internet and American Life, February 2008) (available at *http://www.pewinternet.org/Reports/2008/Online-Shopping/01-Summary-of-Findings.aspx?r=1*).

[22] See PriceWaterhouseCoopers, *Retail Sales Tax Compliance Costs: A National Estimate* (April 7, 2006) at 18 (available at *http://www.netchoice.org/library/cost-of-collection-study-sstp.pdf*).

[23] We utilized the same source for sales tax rates as in the Fox Study, namely the Sales Tax Clearinghouse. Rates represent statewide rates plus local tax rates divided by the state sales tax base, *i.e.,* they represent blended state and local sales tax rates for each state. See *http://www.thestc.com/STrates.stm.*

In our view, these assumptions are arbitrary and unsupportable, and at odds with our research on states where the top 500 e-retailers already collect sales tax.

We believe the *Fox Study* errs in this regard primarily by assuming (or seeming to assume) that all or almost all firms with relatively low online sales fit some combination of two criteria: (a) they are exclusively or almost exclusively "pure play" online retailers, with few if any brick and mortar retail outlets; or (b) they are small firms that lack rigorous tax compliance programs, and/or are not subject to tax audits by state governments. This characterization, however, simply does not comport with the data. While some firms with small online revenues meet these criteria, others are actually large, multi-state brick-and-click retailers that collect taxes in multiple jurisdictions. For example, both Hancock Fabrics and Sur La Table have less than $10 million in online sales, as reported by Internet Retailer. Yet, Hancock Fabrics collects taxes in 36 states, and on 92 percent of its sales, while Sur La Table collects taxes in 21 states, and on 73 percent of its sales. To assume, as the *Fox Study* does, that both of these firms collect taxes on only two percent of sales clearly biases upward their estimate of uncollected sales tax.

Upon examination of the data, we found only a weak correlation between online sales revenues and the proportion of taxes collected. Accordingly, we assumed that the ratio of taxes collected to potential tax collections for smaller firms (those with revenues less than $9 million) is the same as for the "bottom 50" firms in the Internet Retail 500 (firms with online sales of between $9 million and $11.8 million in 2008 online sales), or approximately 26 percent. On that basis, as shown in Table 3, we estimate uncollected taxes among these firms at less than $1.5 billion, assuming no *de minimis* exemption.

Table 3.—Retail Sales and Potential Uncollected Taxes, By Firm Size, 2008

Size Category (Ranked by 2008 E-Retail Sales)	e-Retail Sales ($millions)	Potential Uncollected Sales Tax ($millions)
Large (Top 150)	$95,145	$1,985
Middle (Next 300)	$9,351	$418
Small (Bottom 50)	$514	$27
Subtotal (Internet Retailer 500)	*$105,010*	*$2,430*
Micro (Sales under $9 million)	$27,990	$1,477
Total	*$133,000*	*$3,907*

As the table indicates, summing across these four classes of firms, we estimate total uncollected revenues for 2008 at $3.9 billion.

The last step is to estimate the impact of applying a *de minimis* exemption. As noted above, even proponents of overturning *Quill* recognize that the administrative burdens placed on small sellers (and tax collection agencies) would be very high relative to the amount of taxes collected; and, since some proposals contemplate reimbursing businesses for the collection charges, at least some of those collection costs would have the effect ultimately of reducing net tax collections, thus defeating the purpose altogether. Accordingly, most proposals would create a small business exemption which, for example, would exempt all firms with gross remote (*i.e.,* out-of-state) sales of less than $5 million.[24]

To estimate the impact of such an exemption, we first estimated the amount of remote sales for each firm on the *Internet Retailer 500* list. Then, for firms with less than $5 million in remote sales, we summed our firm-specific estimates of uncollected sales taxes across the firms with less than $5 million in sales. We identified 39 firms out of the top 500 that (a) had less than $5 million in remote sales and (b) did not collect taxes in one or more states.[25] The estimated uncollected taxes for these 39 firms totaled only $4 million.

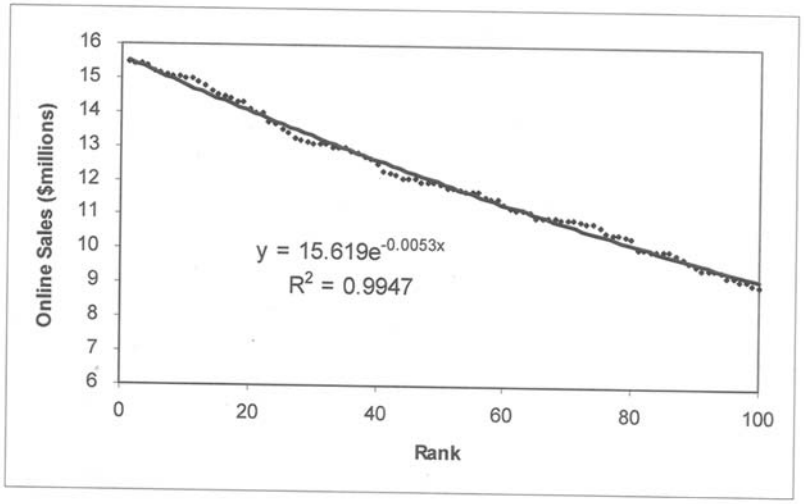
To assess the impact of a $5 million exemption for those retailers which are not on the *Internet Retailer 500* list, we first estimated the shape of the size distribution (based on online sales) for smaller firms. To do so, we fitted an exponential curve (*i.e.,* a regression equation) based on the bottom 100 firms in the *Internet Retailer 500,* and used the regression coefficients to estimate the sales revenues of the next 500 firms. The results of the regression analysis are shown in Figure 2, which demonstrates that our regression model is an excellent fit, with the R-squared statistic

[24] See, *e.g.,* H.R. 3184, 108th Congress, 1st Session, Sec. 4(b).

[25] Note that these firms include both "large" and "small" firms as ranked by overall sales, since the criterion for exemption is that a firm have less than $5 million in *remote* sales.

indicating we have explained approximately 99 percent of the variation in firm size over the relevant range.

Figure 2: Regression Analysis of Firm Size



The results of applying the regression coefficients in Figure 2 to estimate the size of the "next 500" online retailers are shown in Table 4. As the table indicates, the bottom 500 firms on the *Internet Retailer 500* list (firms ranked 401–500) have average e-commerce sales of $12.1 million; the next 100 (ranked 501–600) have estimated average sales of $7.2 million; the next 100 (601–700) have estimated average sales of $4.1 million, and so forth.

Table 4.—Estimated Retail E-Commerce Sales by Firm Size

Firm Rank	Total e-Commerce Sales	Average e-Commerce Sales
401–500	$1,208,032,677	$12,080,327
501–600 (est.)	$717,102,300	$7,171,023
601–700 (est.)	$413,539,010	$4,135,390
701–800 (est.)	$243,411,117	$2,434,111
801–900 (est.)	$143,272,993	$1,432,730
901–1,000 (est.)	$84,977,289	$849,773
Total (501–1,000) (est.)	$1,602,302,708	$3,204,605

One important implication of the data in Table 4 is the fact that estimated retail e-commerce sales for the "second 500"—firms ranked 501–1000 in online sales—total only about $1.6 billion annually, accounting for only 5.7 percent of the $28 billion in online sales we attribute to firms with less than $9 million in sales, based on the Census Bureau and *Internet Retailer* data. Thus, our estimates are consistent with the notion that there is indeed a "long tail" of small online retailers, for example, a tail consisting of five million sellers averaging $5,280 in online sales per year, or a total of $26.4 billion for all firms outside the top 1,000.[26]

To assess the impact of a small business exemption on this group of firms, we assumed that small retailers had the same ratio of in-state to out-of-state sales as the bottom 50 in the *Internet Retailer* list (that is that remote sales accounted for 74 percent of total sales), and on that basis estimate that firms with more than

[26] Indeed, projecting our results to the next 1,000 firms suggests the average online sales of firms ranked 1,001–2,000 are only $120,000, with the 2000th firm having less than $35,000 in sales; total sales in this group are only about $120 million.

$6.76 million in online sales (= $5 million/0.74) would be required to collect sales taxes and all others would be exempt. There are 58 such firms, with estimated remote sales revenues of $339 million. Applying the national average tax rate (7.13 percent) to these sales yields potential uncollected revenues from these firms of approximately $24 million.

With these estimates in hand, we can now calculate the impact of a $5 million small business exemption. We begin with our total estimate of potential uncollected revenues of $3.9 billion, which includes $2.4 billion from the top 500 firms and $1.5 billion from all other firms. As explained above, we estimate that a small business exemption would reduce collections from the top 500 firms by only $4 million. For all other firms it would reduce collections by $1.477 billion minus $24 million, or $1.453 billion. Thus, for 2008, we estimate a small business exemption would reduce potential collections by a total of $1.457 billion. Accordingly, we estimate that the maximum amount of additional revenue that would result from overturning *Quill,* assuming a small business exemption is adopted, is $2.45 billion.[27]

B. Forecast of Uncollected Revenues, 2009–2012

We developed two forecasts for uncollected revenues for the period 2009–2012. The first (baseline) forecast is based on the projected growth of online sales over this period, assuming all other variables remain unchanged. The second (adjusted) forecast is based on the assumption that current trends with respect to collection rates continue—that is, that the proportion of online sales for which firms collect and remit state and local sales taxes continues to increase.

To arrive at our baseline projection, we estimated a simple model of the level of retail e-commerce, variations in which we hypothesize can be explained by (a) overall retail sales and (b) the level of household broadband penetration. Accordingly, we collected data quarterly data on retail e-commerce, total retail commerce, and broadband penetration from 2000 through 2009. We acquired the e-commerce data and total retail commerce data from the Census Bureau's Quarterly E-Commerce Reports.[28] We acquired household broadband penetration data from the Pew Internet & American Life Project's Broadband at Home Survey.[29] Using these data, we specified a regression model where retail e-commerce was the dependent variable and total retail commerce and broadband penetration were the independent variables. Table 5 depicts the results of this analysis:

Table 5.—Regression Analysis of Retail E-Commerce

Variable	Coefficient	T-Stat	P-Value
Constant	17396.6	3.47	0.00
Retail Commerce	0.029	4.45	0.000
Broadband Penetration	37110.7	11.54	0.000
Adjusted R-Squared	*0.95*		
Observations	*38*		

As the data in Table 5 indicate, our two-variable regression analysis explains approximately 95 percent of the variation in retail e-commerce over the nine-year period. Regression coefficients on both of the explanatory variables are, as expected, positive, and t-statistics indicate that they are significantly different from zero at a confidence level of greater than 99 percent. In short, our model is statistically robust and explains nearly all of the variation in retail e-commerce over the sample period.

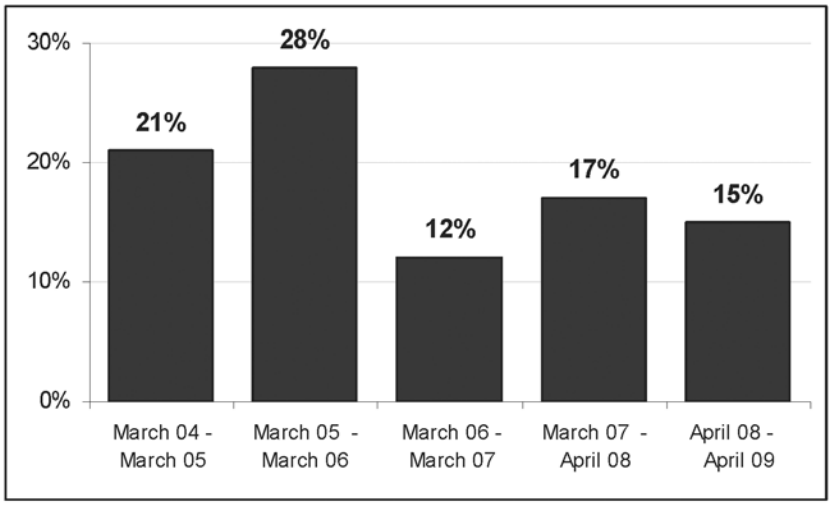
[27] The *Fox Study* also calculates the effect of a *de minimis* exemption. While it takes a very different approach (for example, it appears to base its exemption thresholds on total online sales rather than remote online sales), the effect is, coincidentally, entirely consistent with our estimate: Both methods find that a $5 million *de minimis* exemption would reduce collections by 37 percent of total uncollected revenues.

[28] U.S Census Bureau, *Quarterly Retail E-Commerce Sales,* Q1 2000—Q2 2009. We note that data for prior years are often restated in subsequent reports. In these cases, we used the data reported in the most recent available E-commerce report.

[29] Pew Internet & American Life Project, *Broadband at Home, 2000–2009.* The Pew survey data is reported in different months across different years. Thus, we used a two step algorithm to match the Pew broadband survey data to the census bureau's quarterly e-commerce reports. First, we looked to see if for each quarter there was a survey date that was within that quarter. If there was we assigned that value to the quarter. If there were two surveys within a quarter, we assigned the later survey date. For quarters that were missing survey data, we used the value of the *next* quarter with available data.

We then used this model to forecast retail e-commerce sales for each quarter from Q2 2009 to Q4 2012, using forecasted broadband growth data from Gartner Research and forecasted nominal GDP growth data from the Congressional Budget Office (CBO). With respect to broadband adoption, our forecasts—from the Gartner Group—are consistent with the slowing growth of broadband penetration in recent years. For example, the latest data from the Pew Project on the Internet and American Life, shown in Figure 3, shows that the average annual growth in broadband penetration has fell by nearly 50 percent between 2005–6 and 2008–9, from 28 percent to only 15 percent.

Figure 3: Growth in Broadband Penetration, 2004–2009[30]



Specifically, we based our estimates of broadband penetration on forecasts from Gartner Research, which predicts that U.S. household broadband penetration in 2012 will be 77 percent.[31] Thus, for the purposes of projecting broadband growth we assigned Gartner's penetration estimate of 77 percent to Q4 2012, and allocated the difference between this final projection and Pew's Q2 2009 survey estimate of 63 percent linearly across the remaining quarters.

To project total Retail Commerce through Q4 2012 we simply grew total retail commerce in each quarter by the nominal GDP growth rate projected by the CBO relative to the same quarter in the previous year.[32] Thus, Q3 2009 would simply be total retail sales in Q3 2008 plus the projected 2009 CBO growth rate times total retail sales in Q3 2008. Our projections for 2009–2012 are shown in Table 6.

[30] Source: Pew Project on the Internet and American Life.

[31] Gartner Research, *Gartner Says 17 Countries to Surpass 60 Percent Broadband Penetration into the Home by 2012,* Jul. 24, 2008, available at *http://www.gartner.com/it/page.jsp?id=729907* (Last visited Aug. 31, 2009).

[32] Congressional Budget Office, *Table 2.1: CBO's Economic Projections for Calendar Years 2009 to 2019,* available at *http://www.cbo.gov/doc.cfm?index=10521* (Last visited Aug. 31, 2009).

Table 6.—Retail E-Commerce Baseline Forecast, 2008–2012

[$ billions]

	2008	2009	2010	2011	2012
Retail Commerce					
Level	$3,973	$3,726	$3,834	$3,988	$4,199
YOY percent Change		–6.2%	2.9%	4.0%	5.3%
Broadband Penetration					
*Level**	57.3%	63.8%	67.5%	71.5%	75.5%
YOY % Change	11.3%	5.8%	5.9%	5.6%	
Retail E-Commerce					
Level	$133	$131**	$142	$152	$164
YOY % Change		–1.5%	8.4%	7.0%	7.9%

* *Note that annual BB penetration represents the average value for the year based on our estimates derived from Pew and Gartner.*

** *Note that this figure differs from the 2009 value given in Table 1 because the retail e-commerce figure listed in this table was predicted based on our model's estimates for Q3 and Q4, 2009, while in Table 1 the 2009 projection was created by multiplying the sum of e-retail sales in Q1 and Q2, 2009 by two. The close proximity of the two values serves as a good robustness check on accuracy of our model.*

Table 7 compares our projections for e-commerce growth with those used in the *Fox Study*. Our projections vary substantially, but we believe appropriately, from those advanced in the *Fox Study,* which projects dramatically higher growth in retail e-commerce.

Table 7.—Comparison of Fox vs. Eisenach–Litan Projected E-Retail Growth Rates

	2008	2009	2010	2011	2012	CAGR (2008–2012)
Fox Baseline	6.6%	–10.0%	24.0%	17.6%	12.4%	10.2%
Fox Optimistic	6.9%	–3.1%	32.2%	14.1%	11.7%	13.0%
Eisenach-Litan	3.9%*	–1.3%	8.4%	7.3%	7.9%	5.5%

**Actual, as reported by Bureau of the Census, E-Stats*

The *Fox* estimates are based on a regression model which the authors develop by "regressing the log of e-commerce shipments on the log of nominal GDP and the real GDP growth rate for 1999 through 2006," and then applying projections for GDP growth from a private forecaster, Global Insight, to forecast e-commerce from 2007 through 2012. The result, as shown in Figure 4, is a "hockey-stick" shaped forecast, with a dramatic and unexplained surge in growth in 2010 and beyond. We find no basis for projecting such high growth rates into the future, especially given the slowdown in broadband penetration growth, which effectively limits the growth of "new shoppers" entering the online marketplace.[33]

Applying our projected growth rates to our baseline estimate of $3.9 billion in uncollected 2008 revenues, and assuming no other changes in the makeup of online sales, tax policy, or otherwise, we estimate potential uncollected revenues for the period 2008–2012 will average approximately $4.24 billion annually. Assuming enactment of a small business exemption, however, reduces the figure to an average of $2.67 billion annually. As shown in Table 8, our estimates are substantially less than the *Fox Study's* forecasts over the same period.

[33] We also note that the *Fox Study* authors have dramatically overestimated e-commerce growth rates in their previous studies. See, *e.g.,* Johnson at 2.

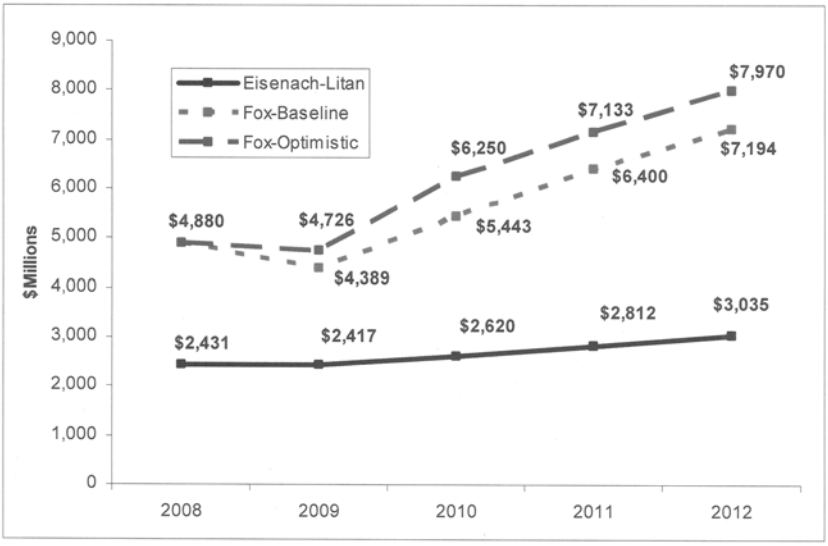
Table 8.—Comparison of Eisenach-Litan vs. Fox Projected Uncollected Taxes

[$ billions, 2008–2012]

	2008	2009	2010	2011	2012	Average
Without Small Business Exemption						
Eisenach-Litan	$3.91	$3.85	$4.17	$4.48	$4.83	$4.25
Fox Baseline	$7.73	$6.95	$8.62	$10.14	$11.39	$8.97
Fox Optimistic	$7.75	$7.50	$9.92	$11.32	$12.65	$9.83
With Small Business Exemption						
Eisenach-Litan	$2.45	$2.42	$2.62	$2.81	$3.04	$2.67
Fox Baseline	$4.88	$4.39	$5.44	$6.40	$7.19	$5.66
Fox Optimistic	$4.88	$4.73	$6.25	$7.13	$7.97	$6.19

The differences in these projections are both quantitative and qualitative in nature. As shown in Figure 5, the *Fox Study*—based on its "hockey stick" forecast for the growth of electronic commerce—forecasts that uncollected tax revenues will grow rapidly in the future. Our forecast, which is based on what we believe to be a far more realistic forecast for e-commerce growth, shows uncollected revenues growing only modestly. Indeed, our five-year forecast shows *nominal* uncollected revenues growing at only about 5.2 percent per year, only slightly higher than recent inflation rates—that is, in real terms, uncollected revenues are growing very slowly, if at all. Perhaps most importantly, our estimates show uncollected revenues—assuming no changes in either state tax collection policies or in the makeup of online sales—remaining nearly constant as a proportion of state and local revenues, remaining below 0.22 percent (one quarter of one percent) of total state and local revenues, and below one percent of sales and use tax revenues, throughout the projection period.[34]

Figure 5: Potential Uncollected Revenue Forecasts, 2008–2012 (assuming *De Minimis* Exemption)



[34] These ratios assume state and local taxes grow at the same rate as Gross Domestic Product throughout the period, *i.e.,* at the same rate assumed in our e-commerce forecast for total retail sales.

IV. Discussion and Implications

Our results have several important policy implications.

Most importantly, our results suggest that uncollected sales taxes are much smaller than previously thought, and that they are growing, if at all, at a much slower rate. Indeed, two factors we have not yet mentioned suggest uncollected sales tax revenues are likely to fall over time, at least as a proportion of all taxes. First, there is some evidence that the online sales of the brick–and-click retail model are growing more rapidly than those of "pure play" purveyors such as *Amazon.com.* For example, according to a survey conducted by the LakeWest Group, nearly three quarters of the top 100 retailers have embraced multichannel retailing and that "[o]f retailers who operate websites, 60 percent have at least some integration between store and site, and more than half allow returns to cross channel."[35] To confirm this trend, we analyzed the growth of sales by "pure play" versus "brick and click" retailers in the *Internet Retailer 500* list, and found that firms that paid taxes on more than 50 percent of their online sales did indeed grow faster between 2007 and 2008 than firms that paid taxes on less than 50 percent of their online sales. These results are consistent with other research suggesting that online sales growth is occurring most rapidly among firms that collect sales taxes on large proportions of their sales. Johnson, for example, concludes that "the future of Internet growth has been shown to be in multi-channel, clicks and bricks,"[36] citing studies performed by Forrester Research that demonstrate "consumers' desire to couple 'clicks'-based shopping with 'bricks'-based merchandise pick-ups and returns."[37] Thus, there are strong reasons to believe that the proportion of online commerce associated with out-of-state sales is falling and will continue to fall over time.

Second, states are not standing still waiting for *Quill* to be overturned, but instead are moving aggressively to use the tools at their disposal. For example, in April 2008, New York State passed legislation asserting nexus for any retailer that has sales affiliates in the state that generate a combined total of $10,000 or more annually in revenues for the retailer.[38] In 2009, at least two state legislatures (Rhode Island and North Carolina) have enacted laws that assert nexus when remote retailers compensate in-state websites for displaying the retailer's advertisements.[39] In July 2009, California Governor Arnold Schwarzenegger signed legislation to improve business compliance with the state's use tax. The California Board of Equalization estimated the new legislation, along with ongoing measures aimed at shrinking the "tax gap," would reduce uncollected revenues from businesses by over 60 percent in the next two years.[40] Furthermore, in recent years, some states have used their leverage as large purchasers to force sales tax collection by online retailers.[41]

Taken together, these two factors suggest that, rather than growing very slowly, as our uncorrected baseline estimates suggest, uncollected sales tax revenues may actually be declining as a proportion of state and local tax revenues, as illustrated in Figure 6.

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[35] See Hamilton at 4.

[36] Johnson at 6.

[37] *Id.*

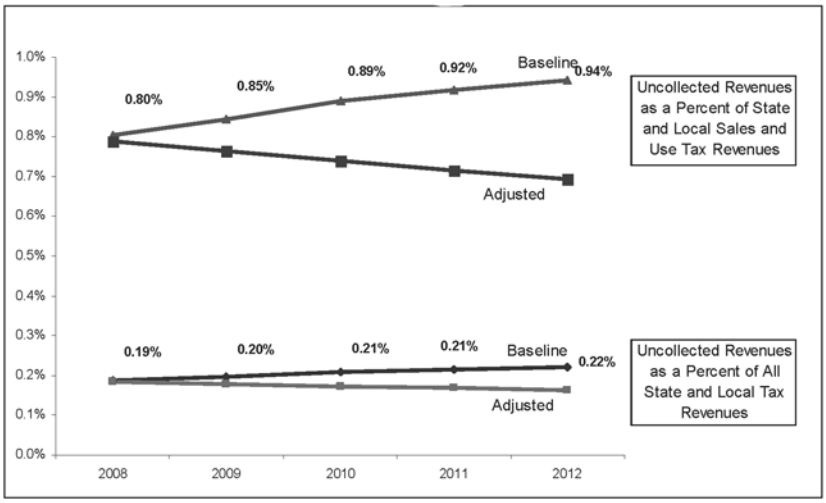
[38] See Hamilton at 5.

[39] See North Carolina GEN. STAT. § 105–164.8, as amended 7-Aug-2009. See also North Carolina Departmetn of Revenue, Form E–505 (9–09) at 2–3 (available at at *http://www.dornc.com/downloads/e505_8-09.pdf*), and Rhode Island Division of Revenue, Department of Taxation, "Important Notice: Definition of Sales Tax 'Retailer' Amended" (available at *http://www.tax.state.ri.us/notice/Retailer_definition_NoticeC.pdf*).

[40] State of California, Board of Equalization, *Electronic Commerce and Mail Order Sales* (November 3, 2009) (available at *http://www.boe.ca.gov/legdiv/pdf/e-commerce-11–09.pdf*). The Board of Equalization estimates uncollected revenues in 2012 at $1.0 billion, far below the *Fox Study's* baseline estimate of $1.9 billion.

[41] See, *e.g.,* Institute for Local Self-Reliance, "Internet Sales Tax Fairness—State Purchasing Provision—North Carolina" (available at *http://www.newrules.org/retail/rules/internet-sales-tax-fairness/internet-sales-tax-fairnessstate-purchasing-provision-north-carolina*).

Figure 6: Potential Uncollected Revenue as a Proportion of State and Local Tax Collections, 2008–2012 (Assuming Small Business Exemption)



A second implication of our research is to provide some support for those who have suggested imposing a collection obligation on only those e-retailers with the highest amounts of uncollected sales tax. Our analysis of 2008 data shows that the ten firms with the largest amounts of uncollected taxes account for 47.3 percent of all uncollected taxes for the *Internet Retailer 500* e-retailers, and 46.9 percent of uncollected revenues for all firms not subject to a $5 million small business exemption.

V. Conclusions

Taxation of remote sales is a hotly debated issue, and as states and localities experience the fiscal stresses associated with the current economic downturn, it is not surprising to hear renewed calls for overturning *Quill* and forcing e-retailers to collect taxes on out-of-state sales. However, a decision to impose such an mandate would have costs as well as benefits. The costs would include increased compliance costs for businesses, increased administrative costs for tax collection agencies, higher vendor compensation payments, and, of course, higher taxes for price-sensitive consumers who rely on online shopping. On the other side of the scale, state and local tax collections would increase. From the perspective of state and local governments, the relevant question is whether the increase in collections would more than outweigh the higher costs. Our research suggests that the increased collections associated with overturning *Quill* would be substantially lower than previously thought—approximately $2.5 billion annually rather than the $7 billion or more estimated in the *Fox Study.* Moreover, our analysis shows that uncollected taxes are not growing rapidly and, indeed, are likely constant or even shrinking as a proportion of state and local tax revenues. With this data in mind, policymakers should consider carefully whether the benefits of overturning *Quill* would exceed the costs.

Appendix: State-By-State Estimates of Potential Uncollected Revenue

In addition to the national estimates presented in the text, we also estimated potential uncollected revenues on a state-by-state basis. As explained in the text, our survey of firms' tax collection practices in each state allowed us, for the firms surveyed, to directly estimate uncollected taxes on a firm-by-firm basis. (Indeed, our national estimates for these firms represent the summation of uncollected taxes across states and firms.) For firms not surveyed, *i.e.,* un-surveyed firms from the *Internet Retailer 500* and firms in the "tail," we estimated potential uncollected revenues though a two-step process. First, we applied our sampling methodology for estimating the taxes avoided for the middle 300 *Internet Retailer* firms on a state-by-state basis.[42] The reason for applying this state-by-state method was that it allowed

[42] That is, for the 50 firms we surveyed in the middle 300, we calculated for each state the proportion of those firms' sales upon which they collected taxes, and then applied that percentage to the estimated state-by-state sales of all 300 firms.

for variation in each state's ratio of sample avoided taxes to sample total taxes, creating a more accurate portrayal of the each state's estimated avoided taxes. Adding the estimated avoided taxes for the middle 300 firms to the avoided taxes for the top 150 and bottom 50 firms within each state yielded the total avoided tax for the top 500 Internet retailers in each state. Second, we then distributed the avoided taxes attributable to firms in the "tail" by allocating the total estimated avoided taxes for firms in the tail on a pro-rata basis according to each state's proportion of taxes avoided by the top 500 Internet retailers.

Having arrived at baseline estimates for 2008, we next calculated an estimate of the impact of applying the small business exemption (SBE). To do so, we first adjusted potential uncollected taxes on a state-by-state basis to omit the surveyed firms in the Internet Retailer Top 500 from the state-by-state calculation, and then calculated potential uncollected taxes for the "tail" by allocating to the states only those potential revenues that would not be affected by the SBE.

Finally, we calculated estimated uncollected revenues for 2012 by applying our national projected growth rate for uncollected revenues to the 2008 estimate for each state.

Our estimates, as well as the 2008 and 2012 baseline estimates from the *Fox Study,* are presented in Table A–1. As the data there indicate, our estimates are substantially below those of the *Fox Study* for every state other than Alaska; and, for some key states, they are dramatically lower. For example, the *Fox Study's* baseline estimate suggests that uncollected revenues in California could reach $1.9 billion by 2012, whereas our estimate of less than $390 million (assuming an SBE) is only one fifth as high. Similarly, the *Fox Study's* baseline estimate indicates state and local governments in New York State could lose as much as $865 million, while our SBE-adjusted results show the correct figure is approximately $105 million. To the extent state revenue collectors and fiscal authorities have viewed the repeal of *Quill* as a "silver bullet" that would make up for a significant portion of current budget shortfalls, the figures in Table A–1 clearly demonstrate otherwise.

Table A-1.—State-by-State Estimates of Potential Uncollected Revenues

[$ Millions, 2008, 2012]

	2008			2012		
State	Fox (baseline)	Eisenach-Litan	Eisenach-Litan with SBE	Fox (baseline)	Eisenach-Litan	Eisenach-Litan with SBE
Alabama	$115.5	$75.3	$46.8	$170.4	$92.8	$57.8
Alaska	$1.0	$3.6	$2.0	$1.5	$4.4	$2.4
Arizona	$250.8	$79.3	$49.5	$369.8	$97.8	$61.1
Arkansas	$77.2	$49.6	$30.6	$113.9	$61.2	$37.7
California	$1,291.6	$503.9	$316.1	$1,904.5	$621.4	$389.8
Colorado	$117.1	$67.8	$42.4	$172.7	$83.6	$52.2
Connecticut	$43.2	$48.2	$30.1	$63.8	$59.4	$37.1
DC	$24.1	$3.5	$2.2	$35.5	$4.4	$2.7
Florida	$545.1	$227.7	$142.9	$803.8	$280.8	$176.2
Georgia	$278.2	$117.2	$73.5	$410.3	$144.5	$90.6
Hawaii	$40.7	$16.2	$9.6	$60.0	$19.9	$11.8
Idaho	$31.4	$17.8	$11.1	$46.4	$21.9	$13.7
Illinois	$343.7	$196.1	$123.0	$506.8	$241.8	$151.7
Indiana	$132.5	$95.9	$59.9	$195.3	$118.2	$73.8
Iowa	$60.1	$48.7	$30.1	$88.7	$60.1	$37.1
Kansas	$96.9	$29.5	$18.4	$142.9	$36.3	$22.6
Kentucky	$74.6	$36.0	$22.4	$109.9	$44.4	$27.6
Louisiana	$268.5	$95.9	$60.1	$395.9	$118.2	$74.1
Maine	$21.7	$18.3	$11.2	$32.1	$22.6	$13.8
Maryland	$124.9	$69.4	$43.5	$184.1	$85.6	$53.6
Mass.	$89.0	$87.9	$55.1	$131.3	$108.4	$68.0
Michigan	$96.0	$134.0	$83.9	$141.5	$165.2	$103.4
Minnesota	$159.6	$86.2	$54.0	$235.3	$106.2	$66.5
Miss.	$91.5	$40.6	$24.9	$134.9	$50.1	$30.8
Missouri	$142.9	$87.6	$54.7	$210.7	$108.0	$67.4
Nebraska	$41.6	$28.5	$17.5	$61.3	$35.1	$21.6
Nevada	$114.6	$40.6	$25.4	$168.9	$50.0	$31.3
New Jersey	$137.3	$123.0	$77.0	$202.5	$151.7	$94.9
New Mexico	$81.7	$26.4	$16.5	$120.5	$32.6	$20.3
New York	$586.9	$135.3	$84.8	$865.5	$166.8	$104.6
N. Carolina	$145.0	$112.4	$70.2	$213.8	$138.6	$86.6
N. Dakota	$10.4	$9.0	$5.5	$15.3	$11.1	$6.7
Ohio	$208.8	$156.1	$97.7	$307.9	$192.5	$120.4
Oklahoma	$95.5	$60.4	$37.4	$140.8	$74.5	$46.1
Pennsylvania	$234.6	$157.0	$98.5	$345.9	$193.6	$121.4
Rhode Island	$19.7	$16.8	$10.5	$29.0	$20.7	$12.9
S. Carolina	$84.5	$63.6	$39.7	$124.5	$78.4	$49.0
S. Dakota	$20.2	$13.2	$8.1	$29.8	$16.2	$10.0
Tennessee	$278.6	$105.1	$65.7	$410.8	$129.6	$81.0
Texas	$590.3	$319.6	$200.4	$870.4	$394.1	$247.2
Utah	$60.0	$35.3	$21.8	$88.5	$43.5	$26.8
Vermont	$17.0	$11.3	$6.8	$25.1	$13.9	$8.3
Virginia	$140.4	$71.9	$45.1	$207.0	$88.7	$55.6
Washington	$191.2	$78.3	$49.1	$281.9	$96.5	$60.6
W. Virginia	$34.3	$24.2	$14.8	$50.6	$29.9	$18.3
Wisconsin	$96.4	$66.9	$41.9	$142.1	$82.5	$51.7
Wyoming	$19.4	$7.9	$4.8	$28.6	$9.8	$5.9

PURPLE BOMB LLC
Hilton Head, SC, July 31, 2012

Hon. JIM DEMINT,
United States Senate,
Washington, DC.

Dear Senator DeMint,

As a longtime resident of South Carolina and the owner of a small business, I wish to express my concerns surrounding Internet Sales Tax legislation that has been introduced to the Congress, namely the Marketplace Fairness Act and the Marketplace Equity Act.

I have been in the retail and wholesale business for over 25 years and started a store on eBay—purplebombauctions—in 1999 to augment my retail presence. Today, my wife and I employee four people that help us market our antiques and artwork including home and commercial bars and supplies, cigars as well as espresso and coffee machines. We have one small brick and mortar store, but the Internet is our main platform. We have used the Internet to grow and expand our business, and we plan to do so for many years to come. Using our own money makes it almost impossible to compete with the giant retail firms. So our only viable avenue of making a living with specialty home decor is online.

However, we are concerned that proposed Internet sales tax legislation would impede our ability to grow our business. The thought of complying with the new, heavy tax burdens that this legislation is trying to impose is truly frightening. Collecting and remitting sales taxes in the two states where we have presence is burdensome, yet we understand that it is our duty as small business owners and citizens of South Carolina. However we simply can't wrap our heads around having to collect taxes for an additional 45 states and what we know to be over 9,000 tax jurisdictions. We previously owned a mail order firm which was entangled in a real situation with small counties asking us to remit to them forms if whether or not we sold anything into that county. It was an accounting nightmare for my wife.

This legislation creates uncertainty and just the discussion of new taxes on my business has jeopardized our business' growth. I had scoped out plans to double the size of my business over the next 6–8 months, but with the unforeseen costs of out-of-state audits, software integration, and filing fees, how can I possibly gain the certainty I need to grow my small business and create jobs?

Additionally, it hardly seems fair that my small business in Hilton Head should be held to the same requirements as super-stores that have accountants, lawyers, and the financial resources to deal with new legislation. While I oppose this legislation outright, at the very least a small business exemption must be included to protect *real* small business job creators (and not just "small sellers") like me from additional tax burdens. Also, there must be a better way to assign an Internet tax (possibly at the Federal level) with one remittance government department instead of multiple state tax auditors.

I have long supported your work in the Senate and very much appreciate your work to try to bring common sense to Washington. Hopefully you can bring some more sense to Washington by urging your colleagues to oppose this anti-small business bill.

Thank you again for all you do.

Sincerely,

TIMOTHY P. JUDGE,
Owner.

Backgrounder—No. 2676, April 6, 2012

CONGRESS SHOULD NOT AUTHORIZE STATES TO EXPAND COLLECTION OF TAXES ON INTERNET AND MAIL ORDER SALES

David S. Addington

Abstract

The U.S. Supreme Court's landmark 1992 decision in Quill Corporation v. North Dakota *protects out-of-state businesses in the Internet era from overreaching by revenue-hungry states. The Court's decision prevents a state from forcing an out-of-state business to serve as the state's sales tax collector if the business has no physical presence in the state and simply takes sales orders by Internet, catalog, or telephone. Congress has under consideration legislation (S. 1832) to overturn the* Quill Corporation *decision. To support a strong national economy and encourage fiscal responsibility among the states, Congress should reject the legislation.*

Congress has under consideration legislation (S. 1832 of the 112th Congress) to allow states to require out-of-state businesses that have no connection to the state, other than taking orders over the Internet, by mail, or by telephone from in-state customers and sending the ordered goods by common carrier or U.S. mail, to become sales tax collection agents for the states. Enactment of such legislation would increase the amount of tax dollars millions of Americans pay, encourage states to increase the size and scope of their governments, favor some states over others in granting Federal authority, and discourage free-market competition in interstate commerce. Accordingly, Congress should not enact the legislation.

The legislation overrules the U.S. Supreme Court's decision in *Quill Corporation* v. *North Dakota.*[1] The *Quill* decision protects out-of-state businesses that have no facilities or personnel in a state, but that receive orders by Internet, mail order catalog, or telephone from in-state customers (called "remote sales"), from the state's desire to force the out-of-state businesses to serve as tax collectors.

- Current law protects out-of-state businesses that take orders by Internet, mail order catalog, or telephone and that have no physical presence in the state from a state government that wants to force them to serve as the state's sales tax collectors, but Congress is considering legislation (S. 1832) to override that protection.
- Under S. 1832, state governments would take more tax dollars from millions of Americans, further intrude into free-market competition in interstate commerce, and increase the propensity for more government spending.
- Hobbling out-of-state businesses that sell through the Internet or mail order catalogs does not help the national economy.
- To avoid weakening the national economy, Congress should preserve existing protections for out-of-state businesses from state governments that want to reach outside their states for new revenue for governments to spend.
- Congress should therefore reject S. 1832.

Many state governments have budgetary and political interests in maximizing the revenues they obtain from out-of-state businesses through sales and use taxes.[2] Many in-state businesses have an economic interest in increasing the costs of doing business for their out-of-state competitors to gain a marketplace advantage.

Thus, it is unsurprising that state governments and their national associations,[3] and brick-and-mortar instate retailers and their trade associations,[4] have endorsed enactment of Federal legislation to override the *Quill* decision and allow state governments to require out-of-state businesses to collect and remit state sales and use taxes on remote sales. Associations representing companies that conduct or facilitate remote selling that is protected under the *Quill* decision from state compulsion to collect and remit sales taxes oppose the legislation.[5]

Congress should reject S. 1832 so that it does not discourage spending restraint in the states and free enterprise in the economy.

In enacting S. 1832, Congress would use its power under the Commerce Clause to regulate interstate commerce, and perhaps its power under the Compact Clause to consent to compacts or agreements among the states, to override the *Quill* decision and allow state governments to increase revenues by requiring out-of-state sellers to collect state sales or use taxes on remote sales.[6] Congress should reject S. 1832 so that it does not discourage spending restraint in the states and free enterprise in the economy.

Quill Decision Protected Out-of-State Sellers from Undue State Burdens on Interstate Commerce

In 1992, the U.S. Supreme Court faced the *Quill* case involving a North Dakota statute that imposed a tax on property purchased for storage, use, or consumption in North Dakota and required retailers to collect the tax from consumers and remit the revenue to North Dakota. North Dakota regulations implementing the statute made clear that retailers covered by the statute included those who engaged in "regular or systematic solicitation of a consumer market in this state."

Quill Corporation ("Quill") was an office supply business incorporated in Delaware, with offices and warehouses in Illinois, California, and Georgia but with no employees, sales representatives, or significant property in North Dakota. Quill solicited sales from North Dakota residents by mail order catalog, advertisements and flyers, and telephone calls. Quill sent the purchased products to customers in North Dakota by U.S. mail or common carrier. Quill had about 3,000 customers in North Dakota and about $1 million in annual sales to them. Quill did not collect and remit the North Dakota use tax on its sales to North Dakota residents. North Dakota sued Quill in state courts for the taxes not remitted, and the case ultimately reached the U.S. Supreme Court.

Quill maintained that the Due Process Clause of the Fourteenth Amendment to the U.S. Constitution ("nor shall any State deprive any person of . . . property, without due process of law") and the Commerce Clause ("The Congress shall have Power . . . To regulate Commerce . . . among the several States") barred North Dakota from imposing the use tax on property purchased from Quill for storage, use, or consumption in North Dakota and from requiring Quill to collect the use tax from customers and remit the collections to North Dakota.

In its decision, the U.S. Supreme Court determined that "there is no question that Quill has purposefully directed its activities at North Dakota residents, that the magnitude of those contacts is more than sufficient for due process purposes, and that the use tax is related to the benefits Quill receives from access to the State" and agreed with the "conclusion that the Due Process Clause does not bar enforcement of that State's use tax against Quill."[7] However, the Court held that the Commerce Clause barred North Dakota from enforcing the state's use tax against Quill.

In discussing the impact of the Commerce Clause with respect to state taxes, the Court noted that "we will sustain a tax against a Commerce Clause challenge so long as the 'tax [1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State.'"[8] The Court noted with respect to the first requirement that "the Commerce Clause and its nexus requirement are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy."[9]

The Supreme Court adopted in *Quill* a bright-line rule that the "negative" or "dormant" aspect of the Commerce Clause, which protects against imposition by a state of unreasonable burdens on interstate commerce even in the absence of congressional exercise of power under the Commerce Clause, does not allow North Dakota to require collection and remittance of the state use tax revenue by a corporation whose only connection with customers in the state is by common carrier or U.S. mail.[10] The Court noted, however, that Congress remains free, by an affirmative exercise of its power under the Commerce Clause, to change that rule.[11]

State supreme courts have generally construed the *Quill* decision narrowly and state taxing power broadly,[12] but states remain bound by the Commerce Clause holding in *Quill* that a state cannot require collection and remittance of a sales or use tax on remote sales by an out-of-state seller who has no connection to the state other than by common carrier or U.S. mail.[13] Thus, the holding in *Quill* continues to protect an out-of-state company that has no facilities, personnel, or other connection to a state, other than a common carrier or the U.S. mail, from a requirement to collect and remit the state's sales or use tax on remote sales. Congress, however, has the authority under the Commerce Clause to take away that protection from the out-of-state businesses, as S. 1832 would do.

Overriding *Quill* Would Cause American Businesses and Individuals to Pay Much More to States in Taxes

Enactment of S. 1832 will increase the amount of tax dollars Americans pay to state governments. Although proponents claim that the legislation causes no "tax increase" because state laws imposing sales and use taxes are already on the statute books and S. 1832 does not itself change those state statutes, there is no denying that businesses and individuals will pay more in taxes out of their pockets as a result of enactment of S. 1832. Indeed, that increase in what remote sellers will collect

from businesses and individuals and remit to the state in tax revenues is precisely why many state governments want Congress to enact S. 1832.

Enactment of S. 1832 will increase the amount of tax dollars Americans pay to state governments.

The National Conference of State Legislatures (NCSL) has noted with respect to S. 1832 that "[t]here will be some who claim that this is a new tax" and that "[t]his legislation will not require any state to levy a sales tax on any product or means of buying a product." Both claims miss the point. As a direct result of enactment of S. 1832, which allows states to require out-of-state remote sellers to collect state sales and use taxes that the *Quill* case currently prevents states from requiring, businesses and individuals will pay much more money to states in sales taxes. Indeed, the NCSL states that, "[a]t a time when states continue to face severe budget gaps states closed shortfalls totaling $72 billion leading into the FY 2012 budget process—it is essential states be allowed to collect the revenue generated by uncollected sales taxes," noting further that "[i]n 2012, states will collectively lose an estimated $23.3 billion in uncollected sales taxes from out-of-state sales, with more than $11.3 billion alone from electronic commerce transactions. . . ."[14]

The NCSL could not have made clearer that its objective in asking Congress to enact S. 1832 is to change Federal law to authorize states to force remote-selling businesses and individuals to pay more money as sales and use taxes to the states, which want more revenue.

Overriding *Quill* Would Give States An Incentive to Increase Revenues Instead of Cutting the Size, Scope, and Cost of State Governments

Although many state governments have faced difficulty with their budgets, especially in a weak economy, slow improvement of state finances has begun.[15] As a general proposition, states should focus on cutting their spending rather than seeking more money in taxes as the means to balance their budgets. Especially in a weak economy, state governments should generally pursue pro-growth, job-creating tax policies rather than taking more money out of the private economy in sales tax collection.

Whether the NCSL-cited estimate of $11.3 billion in additional money that would be paid to states in sales taxes on electronic remote sales is precise or not, it is clear that businesses and individuals will pay more money to states in such taxes as a result of enactment of S. 1832.[16] The Federal Government should not enact legislation such as S. 1832, whose principal purpose is to allow states to reach out of the state and take in yet more tax money from businesses and individuals.

Enactment of S. 1832 Would Favor Some States over Others

The proposed Federal legislation fails to respect the traditional roles of the states as equal sovereign actors in the Federal system and instead has Congress, using its power under the Commerce Clause, favoring some states over others. The Federal legislation has the effect of dividing the states into three classes and gives different federally granted, tax-related authority to the three classes, with some states receiving more than others.

The first class consists of a minority of states, currently numbering 21, that have joined as full members of the multi-state Streamlined Sales and Use Tax Agreement (SSUTA or Agreement), administered by an organization called the Streamlined Sales Tax Governing Board, Inc.[17] The laudable stated purpose of the SSUTA is "to simplify and modernize sales and use tax administration in the member states in order to substantially reduce the burden of tax compliance."[18] Article VI of the SSUTA, however, goes beyond the stated tax-simplification purpose of the agreement and encourages enactment of Federal legislation to overrule *Quill* and authorize states to collect sales or use taxes on "remote sales."

The SSUTA defines "Remote sales" as "sales into a state in which the seller would not legally be required to collect sales or use tax, but for the ability of that state to require such 'remote seller' to collect sales or use tax under Federal authority," the latter referring to the Federal legislation under the Commerce Clause to overrule the *Quill* decision that the SSUTA member states seek.[19] The first class of states gets Federal authority to collect its sales or use tax on remote sales under subsection 3(a) of S. 1832, which provides that "Each Member State under the Streamlined Sales and Use Tax Agreement is authorized to require all sellers not qualifying for a small seller exception to collect and remit sales and use taxes with respect to remote sales sourced to that Member State pursuant to the provisions of the Streamlined Sales and Use Tax Agreement."

Especially in a weak economy, state governments should generally pursue pro-growth, job-creating tax policies rather than taking more money out of the private economy in sales tax collection.

The second class of states consists of states that are not full members of the SSUTA but that adopt state laws that impose SSUTA-like "minimum simplification requirements." Subsection 3(b) of S. 1832 provides that "[a] State that is not a Member State under the Streamlined Sales and Use Tax Agreement is authorized to require all sellers not qualifying for the small seller exception to collect and remit sales and use taxes with respect to remote sales sourced to that State, but only if the State adopts and implements minimum simplification requirements." Under subsection 3(b), the "minimum simplification requirements" are:

- A "single State-level agency to administer all sales and use tax laws";
- A "single audit for all State and local taxing jurisdictions within that State";
- A "single sales and use tax return";
- A "uniform sales and use tax base among the State and the local taxing jurisdictions within the State";
- A requirement that "remote sellers . . . collect sales and use taxes pursuant to the applicable destination rate, which is the sum of the applicable State rate and any applicable rate for the local jurisdiction into which the sale is made"; and
- Various requirements concerning software, certification of service providers remote sellers can use to remit the taxes collected, relief from liability for mistakes not caused by the remote sellers, and 30-day notice of local tax rate changes.

The "minimum simplification requirements" parallel to some extent SSUTA requirements.[20]

The third class of states under the proposed Federal legislation are those that neither wish to join the SSUTA nor wish to adopt the SSUTA-like minimum simplification requirements. Examples of states likely to fall into the third class are Delaware, Montana, New Hampshire, and Oregon, which do not levy general sales taxes. If S. 1832 were enacted, other states could collect sales taxes on remote sales by remote sellers located in those four states even though those four states do not impose general sales taxes on anyone, either in-state or out-of-state. As a result, any remote-seller businesses in Delaware, Montana, New Hampshire, and Oregon, whose state legislatures have made conscious decisions not to impose a general state sales tax, would nevertheless have to collect and remit such sales taxes to other states.

Under S. 1832, the first class of states and the second class of states get Federal authority, the *Quill* decision notwithstanding, to require remote sellers—that is, out-of-state businesses that obtain sales in a state by Internet, mail order, or telephone without having any facilities or personnel in the state—to collect and remit the state's sales or use tax on remote sales. The first class of states that is, the SSUTA full members—get greater flexibility, however, than the second class of states. States in the first class can, acting in concert through the SSUTA governing board, establish their own alternative small seller exceptions, but the second class of states must follow the small seller exception specified in the Federal legislation.[21] Also, states in the first class can, again acting in concert through the SSUTA governing board, change their rules with respect to "sourcing" remote sales (that is, deciding where to treat the sale as having occurred, such as at the point of a product's origin or at its destination, and therefore what state will tax the sale), whereas the other states must follow the sourcing rules set forth in S. 1832.[22]

The third class of states remains covered by the *Quill* decision unless they enact the "minimum simplification requirements" to enter the second class of states or decide to become full members of the SSUTA to enter the first class of states. Clearly, enactment of S. 1832 would pressure the current majority of states that have stayed out of the SSUTA to join the minority of states that are members of the SSUTA.

Enactment of S. 1832 to override *Quill,* authorize state governments to require out-of-state remote sellers to collect sales taxes, and allow SSUTA full member states to have the power to change their sourcing rules from time to time, creates the potential for multiple taxation of the remote sellers in some circumstances, with the same sales transactions taxed by the state of the customer who used the Internet to place the order and the state in which the remote seller is located. Current law prohibits such multiple taxation, but that prohibition expires on November 1, 2014.[23]

As the U.S. Supreme Court has stated, "[P]reservation of local industry by protecting it from the rigors of interstate competition is the hallmark of the economic protectionism that the commerce clause prohibits."

Enactment of S. 1832 Would Discourage Free-Market Competition

The National Conference of State Legislatures has said with respect to state sales taxes that "[a]llowing some remote sellers to avoid collecting this tax is unfair to the main street merchants that make up the lifeblood of our local communities."[24] The SSUTA member states complain that "[a]t a time when Main Street retailers face enormous competitive challenges it is appropriate for Congress to end this unfair treatment."[25] The Federation of Tax Administrators believes "the current system disadvantages 'bricks and mortar' stores to the advantage of out-of-state businesses and this Act will help improve business activities in our states and the employment these in-state businesses generate."[26]

From these statements, it appears that these organizations seek enactment of S. 1832 so that states can prefer in-state businesses over out-of-state businesses in the kind of anti-competitive economic discrimination the U.S. Constitution was in part adopted to prevent. As the U.S. Supreme Court has stated, "[p]reservation of local industry by protecting it from the rigors of interstate competition is the hallmark of the economic protectionism that the Commerce Clause prohibits."[27]

The Constitution of the United States has set the legal baseline—the level playing field—around which the American free-market economy has built itself. The Constitution, as reflected in the *Quill* decision, is the source of the present arrangement regarding collection of state sales and use taxes by remote sellers. Ever since the Supreme Court decided *Quill* in 1992, American businesses have made millions of business decisions in the competitive marketplace based in part on settled expectations regarding state taxation affecting their sales transactions. The states and businesses advocating S. 1832 seek to change the current, constitutionally prescribed playing field. They seek to use governmental power to intervene in the economy to help in-state, store-based businesses by imposing a new tax-collection burden on out-of-state competitors who sell over the Internet, through mail order catalogs, or by telephone. Free-market principles generally discourage such government intervention in the economy to pick winners and losers based on legislative policy preferences.

The Constitution has not set up a system that is "unfair" to "Main Street" or "brick and mortar" retailers. The issue is not "taxable" instate businesses selling from stores competing with "untaxable" out-of-state businesses selling through the Internet. Both types of businesses are taxable through some form of tax in some state (or in many states).

Every sale of goods, whether to a business consumer or an individual consumer, has an order ("I'll take it"), payment ("Cash, check, debit, or credit?"), and a delivery ("Here you go; have a nice day"). If a consumer chooses to go to a store to buy a product, the ordering and delivery typically occur in the seller's physical facility (the store) in a state. If the consumer chooses to go online to buy the product, the ordering occurs online without the involvement of a physical facility of the seller (*i.e.,* the order does not occur in a store), but the sale and delivery require that the seller (directly or through agents) have a physical facility (for example, a warehouse) in some state from which the seller sends goods via common carrier or U.S. mail to the consumer who ordered them online.

Thus, every sale of goods involves at least one physical facility located in one state or another, which provides a basis for taxation by that state. No one has become completely "untaxable."

A consumer's preference between two methods of purchase, such as buying in a store or buying over the Internet, on a given occasion may involve consumer thoughts about price, quality, commercial loyalty, geographical convenience, temporal convenience, perceived pleasantness of the sales method chosen, other reasons, or not much thought at all. A consumer's choice between buying in a store or buying online does not necessarily mean a conscious choice between an in-state and an out-of-state seller, as consumers rarely know the state in which an Internet operation is located. The consumer's choice between buying in a store or buying online does not necessarily even mean a choice between two different sellers. Many companies sell both from stores and through the Internet.[28] Consumers should be free to choose how and where they will buy goods they seek without interference from a state trying to steer that purchase to a local store.

In the long run, the national economy as a whole benefits from allowing consumers to choose freely what they wish to buy, of whatever quality they wish, at whatever prices they choose to pay, and from whatever seller they wish, whether in the same state as the consumer or not. Intervention by the Federal Government

and the states in the consumers' choices by enactment and implementation of S. 1832 would increase the revenues of states, but hobbling out-of-state businesses that sell through the Internet or mail order catalogs does not help the national economy.

Conclusion

Congress should not override the Supreme Court's decision in *Quill Corporation* v. *North Dakota* that the Commerce Clause prohibits a state from requiring out-of-state sellers over the Internet, by catalog, or by telephone that have no connection to a state other than a common carrier or the U.S. mail to collect and remit the state's sales and use taxes. Enactment of S. 1832 would simply encourage state governments to take more money from taxpayers and spend it instead of getting the size, scope, and cost of state governments under control.

The independent decisions of millions of consumers in the free marketplace should decide the appropriate allocation of sales between the store-based model of selling and the non-store-based model of selling, such as Internet sales, and between sellers who are local and sellers who are elsewhere in America. To support a stronger national economy, Congress should reject economic protectionism for local businesses, reject state government bloat, and reject S. 1832.

—*David S. Addington* is Vice President for Domestic and Economic Policy at The Heritage Foundation.

End Notes

1. *Quill Corporation* v. *North Dakota,* 504 U.S. 298 (1992).

2. A useful definition of "sales or use tax" is "a tax that is imposed on or incident to the sale, purchase, storage, consumption, distribution, or other use of tangible personal property or services as may be defined by laws imposing such tax and which is measured by the amount of the sales price or other charge for such property or service." Section 1105(6)(C) of the Internet Tax Freedom Act (47 U.S.C. 151 note).

3. See letters, all dated November 9, 2011, from the National Conference of State Legislatures, Streamlined Sales Tax Governing Board, Inc., National Association of Counties, Federation of Tax Administrators, and heads of the National League of Cities, United States Conference of Mayors, and Government Finance Officers Association to Senators Durbin (D–IL), Alexander (R–TN), Enzi (R–WY), and Johnson (D–SD), available as inserted in the *Congressional Record* at *http://thomas.loc.gov/cgi-bin/query/C?r112:./temp/~r112MkIcsa.*

4. See letter dated November 7, 2011, from the International Council of Shopping Centers, Inc., to Senators Alexander, Durbin, and Enzi; letter dated November 8, 2011, from the National Retail Federation to Senators Durbin, Alexander, Enzi, and Johnson; and letter dated November 9, 2011, from the Retail Industry Leaders Association to Senator Enzi, available as inserted in the *Congressional Record* at *http://thomas.loc.gov/cgi-bin/query/C?r112:./temp/~r112MkIcsa.*

5. See, for example, Direct Marketing Association, statement of November 9, 2011, available at *http://www.the-dma.org/cgi/disppressrelease?article=1521;* Computer & Communications Industry Association, statement of November 9, 2011, available at *http://www.ccianet.org/index.asp?sid=5&artid=270&evtflg=False.*

6. The Commerce Clause of the Constitution (art. I, sec. 8) provides that "The Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes. . . ." The Compact Clause (art. I, sec. 10) provides that "No State shall, without the Consent of Congress . . . enter into any Agreement or Compact with another State. . . ." The Compact Clause "does not require congressional approval of every agreement between or among States." *Star Scientific, Inc.* v. *Beales,* 278 F. 3d 339, 359 (4th Cir. 2002), *cert. denied sub nomine Star Scientific, Inc.* v. *Kilgore,* 537 U.S. 818 (2002). In *United States Steel Corporation* v. *Multistate Tax Commission,* 434 U.S. 452, 468 (1978), the U.S. Supreme Court adopted the standard, first stated in *Virginia* v. *Tennessee,* 148 U.S. 503, 519 (1893), that interstate agreements requiring congressional consent are those "which may encroach upon or interfere with the just supremacy of the United States." Courts might find that the Streamlined Sales and Use Tax Agreement (SSUTA), to which S. 1832 refers, does not encroach upon or interfere with just Federal supremacy and therefore does not require congressional approval under the Compact Clause.

7. *Quill Corporation,* 504 U.S. at 308.

8. *Quill Corporation,* 504 U.S. at 311, quoting *Complete Auto Transit, Inc.* v. *Brady,* 430 U.S. 274, 279 (1977).

9. *Quill Corporation,* 504 U.S. at 312. James Madison, writing near the end of his life, looked back and identified state tax discrimination against interstate commerce as one of the sources of dissatisfaction with the Articles of Confederation:

"The other source of dissatisfaction was the peculiar situation of some of the States, which having no convenient ports for foreign commerce, were subject to be taxed by their neighbors, thro whose ports, their commerce was carryed on. New Jersey, placed between Phila & N. York, was likened to a cask tapped at both ends; and N. Carolina, between Virga & S. Carolina to a patient bleeding at both arms. The Articles of Confederation provided no remedy for the complaint: which produced a strong protest on the part of N. Jersey; and never ceased to be a source of dissatisfaction & discord, until the new Constitution, superseded the old." James Madison, *Debates in the Federal Convention of 1787,* "Preface to Debates in the Convention: A Sketch Never Finished Nor Applied" (New York: Prometheus Books, 1987), p. 5, also available at *http://www. teachingamericanhistory.org/convention/debates/preface.html.*

10. The Court has stated succinctly the nature of the "dormant" or "negative" Commerce Clause: "The Commerce Clause provides that 'Congress shall have Power . . . [t]o regulate Commerce with foreign Nations, and among the several States.' Although the Constitution does not in terms limit the power of States to regulate commerce, we have long interpreted the Commerce Clause as an implicit restraint on state authority, even in the absence of a conflicting Federal statute." *United Haulers Association, Inc.* v. *Oneida-Herkimer Solid Waste Management Authority,* 550 U.S. 330, 338 (2007) (citations omitted). The Court has made clear that "[p]reservation of local industry by protecting it from the rigors of interstate competition is the hallmark of the economic protectionism that the Commerce Clause prohibits." *West Lynn Creamery, Inc.* v. *Healy,* 512 U.S. 186, 205 (1994). The interpretation that the clause imposes an implicit restraint on states, although longstanding, is not without critics. Justice Thomas has said that "[t]he negative Commerce Clause has no basis in the Constitution and has proved unworkable in practice. . .. Because this Court has no policy role in regulating interstate commerce, I would discard the Court's negative Commerce Clause jurisprudence." *United Haulers Association,* 550 U.S. 349 (Thomas, J., dissenting) (citations omitted). Justice Scalia has said that "[t]he historical record provides no grounds for reading the Commerce Clause to be other than what it says—an authorization for Congress to regulate Commerce." *Tyler Pipe Industries, Inc.* v. *Washington State Department of Revenue,* 483 U.S. 232, 263 (1987) (Scalia, J., concurring in part and dissenting in part).

11. *Quill Corporation,* 504 U.S. at 318.

12. See, for example, *Lamtec Corporation* v. *Department of Revenue,* 170 Wash. 2d 838, 851 (Washington 2011)(en banc), *cert. denied,* 132 S. Ct. 95 (2011) (business and occupation tax) ("Although Lamtec did not have a permanent presence within the state, by regularly sending sales representatives into the state to maintain its market, Lamtec satisfied the nexus requirement. We . . . hold that the Department had authority under the commerce clause to impose a B & O tax."); *KFC Corporation* v. *Iowa Department of Revenue,* 792 N.W. 2d 308, 328 (Iowa 2010), *cert. denied* 132 S. Ct. 97 (2011) (". . . we hold that a physical presence is not required under the dormant Commerce Clause of the United States Constitution in order for the Iowa legislature to impose an income tax on revenue earned by an out-of-state corporation arising from the use of its intangibles by franchisees located within the State of Iowa. We hold that, by licensing franchisees within Iowa, KFC has received the benefit of an orderly society within the state and, as a result, is subject to the payment of income taxes that otherwise meet the requirements of the dormant Commerce Clause."); *Truck Renting and Leasing Association* v. *Commissioner of Revenue,* 433 Mass. 733 (2001) (state corporate excise tax applies because Commerce Clause nexus exists when out-of-state truck-leasing company rents out vehicles, knowing that they will enter Massachusetts, and they do, in fact, enter Massachusetts); *Tax Commissioner of the State of West Virginia* v. *MBNA America Bank,* N.A., 220 W. Va. 163, 171 (2007), *cert. denied sub nomine FIA Card Services, N.A.* v. *Tax Commissioner of West Virginia,* 551 U.S. 1141 (2007) (". . . we now hold that the United States Supreme Court's determination in *Quill Corp* v. *North Dakota,* 504 U.S. 298 (1992), that an entity's physical presence in a state is required to meet the 'substantial nexus' prong of *Complete Auto Transit, Inc.* v. *Brady,* 430 U.S. 274 (1977), applies only to state sales and use taxes and not to state business franchise and corporation net income taxes." (parallel citations omitted)).

13. As a practical matter, many of the decisions construing or applying the U.S. Supreme Court's *Quill* decision occur in the courts of the several states, because Federal law (28 U.S.C. 1341) prevents Federal courts from issuing injunctive remedies against state tax collection in many cases. The law states: "The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State." Decisions of state supreme courts construing or applying the

Quill decision may reach the U.S. Supreme Court under the statute that permits the Court to review by writ of certiorari final decisions of the highest courts of a state in which a decision could be had in a case in which "the validity of a statute of any State is drawn in question on the ground of its being repugnant to the Constitution, treaties, or laws of the United States." 28 U.S.C. 1257(a).

14. Letter dated November 9, 2011, from the National Conference of State Legislatures to Senators Durbin, Alexander, Enzi, and Johnson, available as inserted in the *Congressional Record* at *http://thomas.loc.gov/cgi-bin/query/C?r112:./temp/~r112MkIcsa.*

15. See "The Fiscal Survey of States: Fall 2011, Executive Summary," National Governors Association and National Association of State Budget Officers ("The slow improvement in state finances began in 2011 as highlighted by 38 states reporting that they had higher general fund spending in fiscal 2011 compared to fiscal 2010 and continued with 43 states enacting fiscal 2012 budgets with increasing general fund expenditures as compared to fiscal 2011. However, 29 states still have lower general fund spending in fiscal 2012 compared to the pre-recession levels of fiscal 2008, illustrating how significantly state fiscal conditions were affected by the recession."), available at *http://www.nasbo.org/sites/default/files/2011%20Fall%20Fiscal%20Survey%20of%20States.pdf.*

16. For the details of the NCSL-cited estimate, see Donald Bruce, William F. Fox, and LeAnn Luna, "State and Local Government Sales Tax Revenue Losses from Electronic Commerce," The University of Tennessee (April 13, 2009), available at *http://cber.bus.utk.edu/ecomm/ecom0409.pdf.* Note that inclusion in the study title of the phrase "Tax Revenue Losses" reveals a certain mindset about the issue: The inability to have a remote seller collect state sales tax on remote sales is a "loss" of revenue to the state only if one assumes that the state is entitled in the first place to force a remote seller to collect and remit such money. But the *Quill* decision holds plainly that a state is prohibited by the Commerce Clause of the U.S. Constitution from forcing the remote seller to do so (absent enactment of Federal legislation authorizing it). Thus, the question involved in considering S. 1832 is not whether a state is "losing" revenue absent Federal legislation, but rather whether Congress should pass such legislation to allow the state to "gain" revenue that the Constitution, as construed in *Quill,* does not now allow the state to require the remote seller to provide. Note also that the University of Tennessee's study bears on its cover page the note that "the authors are grateful to [name of the Executive Director] of the Streamlined States Governing Board."

17. Streamlined Sales and Use Tax Agreement, adopted November 12, 2002, and amended through December 19, 2011, available at *http://www.streamlinedsalestax.org/index.php?page=modules.* The Streamlined Sales Tax Governing Board, Inc., headquartered in Nashville, Tennessee, lists 21 states as members (Arkansas, Georgia, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, Nevada, New Jersey, North Carolina, North Dakota, Oklahoma, Rhode Island, South Dakota, Vermont, Washington, West Virginia, Wisconsin, and Wyoming) and three states as associate members (Ohio, Tennessee, and Utah). Section 801.1 of the SSUTA defines a "full member" as "a state that has been found in compliance pursuant to Sections 804 and 805 and the changes to their statutes, rules, regulations or other authorities necessary to bring them into compliance are in effect." Section 801.3 of the SSUTA defines "associate state" as "a state that has achieved substantial compliance with the terms of the Agreement taken as a whole, but not necessarily each provision as required by section 805, measured qualitatively." Section 804 of the SSUTA provides that the "governing board shall determine if a petitioning state is in compliance with the Agreement" and that "[a] three-fourths vote of the entire governing board is required to approve a state's petition for membership." Section 805 states in full: "A state is in compliance with the Agreement if the effect of the state's laws, rules, regulations, and policies is substantially compliant with each of the requirements set forth in the Agreement." The Internet website address of the corporation known as the Streamlined Sales Tax Governing Board, Inc., is *http://www.streamlinedsalestax.org.* Under section 3(a) of S. 1832 and the definition of "Member State" in section 6(3) of the legislation, the Federal authority granted by section 3(a) extends only to full members of the SSUTA and not to associate states. For an early discussion of concerns with the idea of a state sales tax cartel, see "Why Congress Should Not Authorize a State Sales Tax Cartel," The Heritage Foundation, *Executive Memorandum* No. 778 (September 26, 2001), available at *http://s3.amazonaws.com/thf__media/2001/pdf/em778.pdf.*

18. SSUTA, section 102.

19. SSUTA, section 605. The definition of "Remote sales" applies to sections 606 to 613 in Article VI of the SSUTA.

20. See, for example, SSUTA sections 301 (single agency), 302 (uniform tax base), and 318 (single tax return).

21. Subsection 3(a) of S. 1832 excludes SSUTA member states from collecting sales and use taxes under the legislation from sellers "not qualifying for *a* small seller exception." Subsection 3(b) excludes SSUTA non-member states from such collection from sellers "not qualifying for *the* small seller exception" (italics added to emphasize the distinction between the articles "a" and "the"). Courts assume that the use of different terms within related provisions in a statute generally implies that different meanings were intended. See *Russello* v. *United States,* 464 U.S. 16, 23 (1983) ("We refrain from concluding here that the differing language in the two subsections has the same meaning in each. We would not presume to ascribe this difference to a simple mistake in draftsmanship.") Subsection 3(c) of the bill, captioned "SMALL SELLER EXCEPTION," protects small businesses from having to collect state sales and use taxes on remote sales if they do not have "gross annual receipts in total remote sales in the United States in the preceding calendar year exceeding $500,000." The most reasonable construction of the phrase "*the* small seller exception" in subsection 3(b) is that it refers to the small seller exception set forth in subsection 3(c). In contrast, the most reasonable construction of the phrase "*a* small seller exception" in subsection 3(a) is that it refers to the small seller exception set forth in subsection 3(c) or a present or potential alternative small seller exception. The alternative small seller exception may be that contemplated by section 610 of the SSUTA. Section 610 of the SSUTA states that, taking various factors into account, the SSUTA governing board "shall develop a sales volume threshold for determining which small 'remote sellers' qualify for an exemption from the requirement to collect sales or use taxes on 'remote sales'." Section 610 of the SSUTA gives a further instruction that "[t]he exemption threshold shall be set at a relatively low level and over time adjusted downward so that only sellers making isolated or occasional sales are excluded from the collection requirement." In light of subsections 3(a) and 3(b) of S. 1832 and section 610 of the SSUTA, courts may well construe the reference to "*a* small seller exception" in subsection 3(a) as indicating that the SSUTA member states could, if they wish, adopt (through concerted action in a vote of the SSUTA governing board) a small seller exception of whatever sales volume threshold and follow that state law–based small seller exception instead of following the small seller exception in subsection 3(a) of S. 1832. Under that construction of S. 1832, SSUTA member states would be free under subsection 3(a), by acting in concert in a vote of the SSUTA governing board, to require remote sellers with total U.S. remote sales gross annual receipts under $500,000 to collect and remit state sales and use taxes, but SSUTA non-member states could not do so under subsection 3(b).

22. Subsection 3(a) of S. 1832 grants authority to require sellers (excluding those within the small seller exception) to collect and remit sales and use taxes with respect to remote sales "sourced to that Member State pursuant to the provisions of the Streamlined Sales and Use Tax Agreement." Then subsection 6(8) of the bill repeats that "[a] State granted authority under section 3(a) shall comply with the sourcing provisions of the Streamlined Sales and Use Tax Agreement." Lastly, section 6(10) defines the term "Streamlined Sales and Use Tax Agreement" to mean "the multi-State agreement with that title adopted on November 12, 2002, as in effect on the date of enactment of this Act and as further amended from time to time." Subsections 6(8) and 6(10), including the phrase "as further amended from time to time," read with the text of section 3(a), allow SSUTA member states, acting in concert through a vote of the SSUTA governing board, to change sourcing rules applicable to them under S. 1832 by making changes (without any involvement by Congress or any of the rest of the Federal Government) in the SSUTA sourcing rules. In contrast, states in the second class are bound by the unchanging sourcing rules set forth in section 6(8) of S. 1832. Courts might not uphold the congressional delegation to the private party Streamlined Sales Tax Governing Board, Inc., which by three-fourths vote has the power to amend the SSUTA under section 901 of the SSUTA, of legislative power to change the sourcing rules applicable under Federal law (S. 1832 if enacted) for SSUTA member states. The ability of the Streamlined Sales Tax Governing Board, Inc., to change from time to time the Federal law rule on sourcing applicable to SSUTA member states might be construed as creating Federal law without following the constitutional requirements of bicameral passage by the Houses of Congress and presentment to the President required for the making of a Federal law. For an early recommendation on sourcing, see "After the Net Tax Commission: The Gregg–Kohl Nexus Solution," The Heritage Foundation, *Backgrounder* No. 1363 (April 25, 2000) (". . . by making it clear that extraterritorial taxation would be prohibited in virtually all cases, S. 2401 would encourage state and local governments to adopt an 'origin-based' tax methodology

under which they would levy sales taxes only on companies whose principal place of business resided within their taxing jurisdiction. Sourcing all sales to the location of origin instead of the destination of sale would enable state and local governments to impose taxes on Internet (and catalog) sales in the same way they impose them on traditional Main Street retail sales."), available at *http://www.heritage.org/research/reports/2000/04/after-the-net-tax-commission?query=After+the+Net+Tax+Commission:+The+Gregg-Kohl+Nexus+Solution.*

23. Section 1101 of the Internet Freedom Tax Act (47 U.S.C. 151 note) provides that "[n]o State or political subdivision thereof shall impose any of the following taxes during the period beginning November 1, 2003 and ending November 1, 2014: . . . (2) Multiple or discriminatory taxes on electronic commerce." Section 1105 of the Act defines "discriminatory tax" and "multiple tax" for purposes of the Act. A "multiple tax" is "any tax that is imposed by one State . . . on the same . . . electronic commerce that is also subject to another tax imposed by another State . . ., without a credit . . . for taxes paid in other jurisdictions."

24. See letter dated November 9, 2011, from National Conference of State Legislatures to Senators Durbin, Alexander, Enzi, and Johnson, available as inserted in the Congressional Record at *http://thomas.loc.gov/cgi-bin/query/C?r112:./temp/~r112MkIcsa.*

25. See letter dated November 9, 2011, from Streamlined Sales Tax Governing Board, Inc. to Senators Durbin, Alexander, Enzi, and Johnson, available as inserted in the Congressional Record at *http://thomas.loc.gov/cgi-bin/query/C?r112:./temp/~r112MkIcsa.*

26. See letter dated November 9, 2011, from Federation of Tax Administrators to Senators Durbin, Alexander, Enzi, and Johnson, available as inserted in the *Congressional Record* at *http://thomas.loc.gov/cgi-bin/query/C?r112:./temp/~r112MkIcsa.*

27. *West Lynn Creamery, Inc.* v. *Healy,* 512 U.S. 186, 205 (1994).

28. For example, the well-known retailers Wal-Mart Stores, Inc., and Target Corporation sell from stores in nearly every state (all states in the case of Wal-Mart as of December 31, 2010, and all but Vermont in the case of Target Corporation as of January 29, 2011) and also accept customer orders electronically over the Internet at the company sites on the World Wide Web at *www.walmart.com* and *www.target.com.* Wal-Mart Stores, Inc., "Fiscal 2011 Unit Count," available at *http://walmartstores.com/sites/annualreport/2011/financials/Fiscal2011_Unit_Count.pdf*; Target Corporation, Annual Report for 2010, Securities and Exchange Commission Form 10–K, Item 2. Properties, available at *http://www.sec.gov/Archives/edgar/data/27419/000104746911002032/a2201861z10-k.htm.*

TIKI PUG MUSIC
July 30, 2012

Hon. DEAN HELLER,
United States Senate,
Washington, DC.

Dear Senator Heller,

I understand that the Senate Commerce Committee has scheduled a hearing later this week to examine legislation that would impose new taxes on sales made over the Internet. We have met previously to discuss this issue when I was in Washington, DC, but since you are a member of the Commerce Committee, I wanted to restate my continued opposition to the Marketplace Fairness Act.

First, I must thank you for your leadership on this issue. I know you are a small business supporter and understand the challenges this legislation would create for start-up entrepreneurs, including me. You have been a solid advocate for small businesses that use the Internet, and I appreciate your forward-looking perspective on this issue.

I started using the Internet to sell my wares about 13 years ago, focusing on selling CO's through eBay.com. Then, about four years ago, an illness prompted me to change my course and pursue my dream of becoming my own boss. I ramped up my activity on eBay, and today I have a business partner, employ an assistant, and use my expertise to teach my fellow eBay sellers how to successfully thrift and profit from it.

I have plans to bring my business to the next level, but worry that new sales tax requirements would block my ability to grow my store. As you know, small businesses are less capable of dealing with sales tax collection requirements that would be imposed on them under the Marketplace Fairness Act. I don't have a fulltime accountant, and I can't afford to hire someone. And while I know that the bill would

require states to help small businesses afford sales tax collection costs, I sincerely question whether Nevada—with its record budget deficits—will be able to help me manage the costs associated with the new tax.

This is also a competition issue. Small businesses will always be smaller than the super retailers that do the vast majority of all retail sales in this country and abroad. It hardly seems fair that a small business like mine should be held to the exact same 9,500+ sales tax laws as really large businesses that have stores in almost every American city. Plus, protecting small businesses from sales tax collection liabilities would give them just a little bit of room to grow their operations, and when they get big enough, they too would take on the collection requirements.

Lastly, I appreciate your view that Internet sales tax legislation would increase taxes. The Marketplace Fairness Act's collection requirement means that ultimately small businesses would be subject to a new tax. I know that use tax has always been payable and small businesses have to collect in states where they have locations. But make no mistake about it—the proposed law would be a tax on my business and I would have to endure a *new* burden.

In conclusion, I want to again thank you for your leadership and foresight on this issue. It's good to know that there are some Members of Congress that truly seek to do the right thing. Thank you for all you do.

Sincerely,

JASON T. SMITH,
Owner,
TikiPug Music.

cc: The Honorable John D.Rockefeller, Chairman,Senate Committee on Commerce, Science, and Transportation

The Honorable Kay Bailey Hutchison, Ranking Member, Senate Committee on Commerce, Science, and Transportation

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CONSERVATIVES SUPPORT E-FAIRNESS

New Jersey Governor Chris Christie:

Governor CHRIS CHRISTIE. "I just want to make clear that I have been working on this issue in my role on the executive committee of the National Governors Association because it is an important issue to all the Nation's governors. And I too—along with governors like Governor Daniels and others—urge the Federal Government and the Congress in particular to get behind Senator Lamar Alexander's legislation to allow states to be able to make these choices for themselves. And I think Senator Alexander's legislation would be a great step forward in that regard. It would give states options to decide how they want to deal with this and not have to any longer deal with the Federal prohibition on dealing with it. So, it would allow us to do it in a much more uniform and broader way. So, I'm with Governor Daniels on this and other Republican governors—Governor Snyder of Michigan and others who feel strongly about it. And we've been working on it at the National Governors Association and I know we will continue to and hope to get some type of resolution to it by the end of this year." (Press Conference, Governor Chris Christie, 5/31/12)

Maine Governor Paul LePage:

"Last week, Gov. Paul LePage, R-Maine, wrote his state's two U.S. Senators, Republicans Susan Collins and Olympia Snowe, to urge them to back legislation introduced by Sens. Mike Enzi, R–Wyo., Dick Durbin, D–Ill., and Lamar Alexander, R–Tenn., that would close a loophole left by a 1992 Supreme Court decision. The high court ruled that states can't require retailers such as catalog and now online retailers to collect sales taxes from customers in states where those companies have no physical presence. 'There's no denying that passing the bill would give thousands of small Maine businesses a real boost,' LePage wrote. 'Through no fault of their own, Federal policy now gives some out-of-state corporations an unfair advantage over other Maine retailers.'" (Juliana Gruenwald, "Tea Party Governor Is Backing Net Sales Tax Bill," National Journal, 3/20/12)

Tennessee Governor Bill Haslam:

"The National Governors Association applauds your efforts to level the playing field between Main Street retailers and online sellers by introducing S. 1832, the 'Marketplace Fairness Act.' This common sense approach will allow states to collect the taxes they are owed, help businesses comply with different state laws, and provide fair competition between retailers that will benefit consumers." (National Gov-

ernors Association Letter To Sens. Durbin, Enzi, Tim Johnson And Alexander Endorsing S. 1832, The Marketplace Fairness Act, 11/28/11)

Al Cardenas, Chairman, American Conservative Union (ACU):

"When it comes to sales tax, it is time to address the area where prejudice is most egregious—our policy towards Internet sales. At issue is the Federal Government exempting some Internet transactions from sales taxes while requiring the remittance of sales taxes for identical sales made at brick and mortar locations. It is an outdated set of policies in today's super information age, when families every day make decisions to purchase goods and services online or in person. Moreover, it's unfair, punitive to some small businesses and corporations and a boon for others." (Al Cardenas, "The Chief Threat To American Competitiveness: Our Tax Code," National Review Online, 11/8/11)

William F. Buckley, Editor At Large, National Review:

"The mattress maker in Connecticut is willing to compete with the company in Massachusetts, but does not like it if out-of-state businesses are, in practical terms, subsidized; that's what the non-tax amounts to. Local concerns are complaining about traffic in mattresses and books and records and computer equipment which, ordered through the Internet, come in, so to speak, duty free." (William F. Buckley, "Get That Internet Tax Right," National Review Online, 10/19/01)

Indiana Governor Mitch Daniels:

"[S]ales taxes that [states] impose ought to be paid, and paid by everybody equally and collected by everybody in the retail business . . . We're not talking about an additional or new tax here—we're talking about the collection of a tax that's existed a long time." (Jeremy Hobson, "Indiana Makes A Deal With Amazon On Sales Taxes," Marketplace Business, 1/12/12)

Former Mississippi Governor Haley Barbour:

". . . [E]-commerce has grown, and there is simply no longer a compelling reason for government to continue giving online retailers special treatment over small businesses who reside on the Main Streets across Mississippi and the country. The time to level the playing field is now . . ." (Letter To Sens. Enzi And Alexander Endorsing S. 1832, The Marketplace Fairness Act, 11/29/11)

Former Florida Governor Jeb Bush:

"It seems to me there has to be a way to tax sales done online in the same way that sales are taxed in brick and mortar establishments. My guess is that there would be hundreds of millions of dollars that then could be used to reduce taxes to fulfill campaign promises." (Letter To Florida Governor Rick Scott, 1/2/11)

Indiana Representative Mike Pence:

"I don't think Congress should be in the business of picking winners and losers. Inaction by Congress today results in a system today that does pick winners and losers." (House Judiciary Committee, Hearing On "Constitutional Limitations On States' Authority To Collect Sales Taxes In E-Commerce," 11/30/11)

Virginia Governor Bob McDonnell:

"'This bill helps to ensure that online retailers with a physical presence in Virginia are treated the same as traditional brick-and-mortar retailers who are already required to collect and remit existing sales taxes on goods sold in the commonwealth.'" (Press Release, "Governor McDonnell Announces Agreement Reached On Tax Fairness Bill," Governor Bob McDonnell, 2/22/12)

Michigan Governor Rick Snyder:

"Technology currently exists to quickly and effectively calculate taxes due on sales and can be easily be integrated into online retailers' operations," wrote Snyder, a onetime venture capitalist and former executive at the computer company Gateway. "It is time for Congress to grant states the authority to enforce sales tax and use laws on all retailers doing business in their state." (Bernie Becker, "Michigan Governor Joins Online Sales Tax Chorus," *The Hill,* 5/11/12)

Alabama Governor Robert Bentley:

"Alabama's Republican governor has urged lawmakers from his state to support online sales tax legislation, adding to the growing roster of GOP officials who are on board with the idea. Gov. Robert Bentley told Alabama's two senators and seven House members the online sales tax bills would improve the state's fiscal situation, and stressed that the legislation would not create a new tax. 'The bills will give Alabama the authority to collect sales taxes—as we currently do from local brick-and-

mortar retailers—that are already owed from online retailers,' Bentley wrote in a letter dated April 19. 'Allowing us to effectively close this sales tax loophole would help both our state's finances and our state's small businesses.'" (Bernie Becker, "Alabama Governor Gets Behind Online Sales Tax Push," *The Hill,* 4/25/12)

South Dakota Governor Dennis Daugaard:

"On March 11, South Dakota enacted S.B. 146, sales tax legislation that requires out-of-state retailers that sell to in-state residents to notify their customers of their personal use tax obligation. Under the law, online sellers are required to provide clear notice to consumers during the checkout process that a South Dakota use tax is due." (Rosemary Hawkins, "Sales Tax Bills Pass In Arkansas And South Dakota," American Booksellers Association, 3/3/11)

Georgia Governor Nathan Deal:

"Gov. Nathan Deal is considering extending the state sales tax to online purchases, he told newspaper publishers Thursday morning . . . 'In the absence of congressional activity on that . . . I think there will be some appetite to act on that in the legislature,' he said." (Walter C. Jones, "Ga. Considers Online Sales Tax," The Augusta Chronicle, 1/12/12)

Nevada Governor Brian Sandoval:

"'The only way to completely resolve this issue is for Congress to enact legislation that, within a simplified nationwide framework, grants states the right to require collection by all sellers,' Sandoval said in a statement." (Ed Vogel, "Gov. Sandoval Reaches Sales Tax Deal With Amazon," *Las Vegas Review-Journal,* 4/24/12)

Idaho Governor C.L. "Butch" Otter:

"Gov. C.L. 'Butch' Otter backs taxing Internet sales to level the playing field between virtual businesses and brick-and-mortar establishments on Idaho's Main Street. Otter made the remarks to Idaho chamber of commerce leaders meeting in Boise on Monday." ("Idaho Governor Supports Internet Sales Tax," The Associated Press, 1/30/12)

South Carolina Governor Nikki Haley:

"'And I will tell you regardless of what happens with Amazon, we want them. I have told them we want you to do business in this state, but we want you to do it on a level playing field. They got free property, they got tax incentives, they got plenty of things. Don't ask us to give you sales tax relief when we're not giving it to the book store down the street or we're not giving it to the other stores on the other side of town, it's just not a level playing field.'" (Press Conference, Governor Nikki Haley, 4/28/11)

Iowa Governor Terry Branstad Supports Federal E-Fairness Legislation:

"Gov. Terry Branstad of Iowa this week became the latest in a string of top Republican state officials to back Federal legislation giving states more freedom to collect online sales taxes. Branstad's letter of support, obtained exclusively by The Hill, comes not long after another prominent Republican governor, Chris Christie of New Jersey, also urged Congress to get moving on sales tax legislation . . . In a letter sent Thursday, Branstad encouraged his home-state senators to support a solution that he said would close a longstanding loophole. 'I understand that the coalition supporting this legislation is now very broad which gives me hope that, under your leadership, this legislation can be passed yet this year,' Branstad wrote to Sens. Chuck Grassley (R) and Tom Harkin (D). 'The Internet is now a robust, mature and dynamic marketplace that does not warrant special protections,' he added. 'The application of sales taxes only to 'brick-and-mortar' retailers, many of which are small businesses, puts those very entities at a competitive disadvantage.'" (Bernie Becker & Kevin Bogardus, "GOP Governors Bolster Sales Tax Push," *The Hill,* 6/10/12)

Christopher Caldwell, Senior Editor, The Weekly Standard:

"California governor Jerry Brown killed two birds with one stone last month when he signed a law that would require Internet retailers to collect the state's 7.25 per cent sales tax. He was raising needed revenue. And he was addressing a great injustice of the information age. State and Federal legislators made a big mistake when they exempted e-commerce from taxes in the 1990s. They were giddy with the rhetoric of cyberanarchism and inspired by anti-tax yahoos convinced raising revenue is an optional part of running a government. The kindest thing one can say about the policy is that it constituted an overgenerous subsidy to an infant industry." (Christopher Caldwell, "Why Amazon's Tax-Free Landscape Needs Bulldozing," *Financial Times,* 7/15/11)

RESPONSE TO WRITTEN QUESTION SUBMITTED BY HON. FRANK R. LAUTENBERG TO PAUL MISENER

Question. Senator Enzi's bill would exempt businesses with less than five hundred thousand (500,000) dollars in out-of-state sales nationally. An alternative would be to exempt businesses from having to collect in a given state if their sales in that state are below a certain level. Based on your experience with Amazon Marketplace sellers, would they prefer such a state-by-state exemption?

Answer. We believe that mid-sized sellers—those with about five hundred thousand dollars of annual interstate sales—want simplicity, including a small seller exception (SSE) threshold that is easy to understand and implement. A national threshold for the SSE would be easiest for these sellers to administer.

RESPONSE TO WRITTEN QUESTION SUBMITTED BY HON. MARK BEGICH TO PAUL MISENER

Question. We have heard small brick-and-mortar stores raise concerns about how customers come into their store, look around for a particular item, ask for advice from retail associates and then take that information and buy the same product online to evade paying the sales tax. Do you think evading sales taxes is one of the primary reasons customers choose to shop online? Do you believe that the Internet marketplace has negatively impacted Main Street America? Do you think that the customers, when they buy online, are buying from small businesses or mainly large businesses?

Answer. We believe that customers choose to shop at Amazon because of our low prices, vast selection and fast delivery. As analysts have noted, we offer customers the best prices with or without sales tax.

Further, we believe that the Internet has empowered consumers and Main Street retailers alike. At Amazon, we help over two million sellers (most of them small and medium sized) grow and reach customers across the globe. Forty percent of the items purchased by Amazon customers are sold by these small businesses and independent sellers. Also, a recent study reported by the National Retail Federation shows that "the percentage of shoppers who research products before purchasing them is considerable: 91 percent regularly or occasionally turn to the Internet to do some investigating before heading out to the store to make a purchase." (BIGinsight, Media Behaviors and influence Survey, June 2012.)

WRITTEN QUESTIONS SUBMITTED BY HON. JIM DEMINT TO PAUL MISENER

As of September 27, 2013, the date the record for this hearing closed, Mr. Misener had not responded to the following questions which Senator DeMint submitted to Mr. Misener more than one year previous.

Question 1. Does Amazon collect sales taxes for third parties that use its platform to make sales? Does Amazon receive any compensation for providing this service? Would the use of this service increase if the Marketplace Fairness Act were enacted?

Question 2. How many third party sellers sell exclusively through the Amazon platform? Will Amazon's sales tax collection services apply to third party vendor sales on other web platforms? Will such vendors have to acquire [and presumably pay for] another service and/or software to comply with sales tax laws for transactions not made on the Amazon platform?

Question 3. In testimony before the Committee, one of the sponsors of the Marketplace Fairness Act indicated that taxation would be applied based on the credit card billing address of a purchaser. Do you believe this is accurate, and that the question of appropriate tax application is that simple?

Question 4. We have heard the term "showrooming" often spoken of in a negative way. It has been stated that consumers "showroom" in order to purchase from online sources primarily or exclusively to "avoid" paying sales tax. Do you think it is wrong that consumers are empowered by technology and retail competition to locate what they consider the best price for the product they seek? How often does "showrooming" lead to a purchase being made online, but from a source required to collect sales tax? Do you believe there are reasons other than sales tax collection that lead consumers to purchase from an online source versus a physical retailer?

Question 5. It has been stated that, without the interstate regulatory authority granted to states by the MFA, income and/or property taxes will likely be increased by states. Has Amazon received any property tax or sales tax collection incentives

from state and/or local governments? If so, could you provide the Committee with the estimated value of those incentives?

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. JIM DEMINT TO STEVE BERCU

Question 1. You write in your testimony that, "A sale is a sale no matter where it takes place." The MFA, however, does not treat all sales equally. In fact, it applies a wholly different taxation regime to remote sales versus what is applied to brick and mortar sales. If the goal of the MFA is fairness, shouldn't the outcome be to tax all sales under the same regime?

Answer. I believe that the question of sales tax fairness should be left to the states. I also believe that the residence of the consumer should control the sales tax. So fairness dictates that the rate in each consumer's state of residence would apply.

Question 2. In your testimony you state, ". . . BookPeople already collects for every jurisdiction that has a sales tax. . . . We do so because it is the right thing to do. . . ."

Question 2a. Do you believe it would be fair for other states to require you to obtain their business licenses, comply with their labor laws, or pay them income taxes in order to sell products to consumers in those states?

Answer. As I understand it I am required to obtain business licenses, comply with labor laws and pay income taxes in states where I conduct business. I am not required to comply when consumers come to my state to do business with me. However it makes sense for me to act as a collection agent for remote states just as I do for Texas when someone buys something from me.

Question 2b. Do you believe states should be prohibited from imposing any taxes and regulations outside of their own borders? If not, which ones should be allowed?

Answer. I agree that states should not impose any taxes and regulations outside of their own borders. Getting help collecting sales tax due from their own residents is something very different.

Question 3. In testimony before the Committee, one of the sponsors of the Marketplace Fairness Act indicated that taxation would be applied based on the credit card billing address of a purchaser. Do you believe this is accurate, and that the question of appropriate tax application is that simple?

Answer. I believe that the credit card billing address is the appropriate address for sales tax purposes.

Question 4. We have heard the term "showrooming" often spoken of in a negative way. It has been stated that consumers "showroom" in order to purchase from online sources primarily or exclusively to "avoid" paying sales tax.

Question 4a. Do you think it is wrong that consumers are empowered by technology and retail competition to locate what they consider the best price for the product they seek?

Answer. I believe that consumers should use whatever tools they have at hand to get the best deal they can, but I do not believe that they should be able to use those tools to avoid paying sales tax in their home states.

Question 4b. How often does "showrooming" lead to a purchase being made online, but from a source required to collect sales tax?

Answer. I do not have the data necessary to answer this question.

Question 4c. Do you believe there are reasons other than sales tax collection that lead consumers to purchase from an online source versus a physical retailer?

Answer. Yes and as I noted in Q.4A above I agree with their ability to do so if sales tax avoidance is not the reason.

Question 5. It has been stated that, without the interstate regulatory authority granted to states by the MFA, income and/or property taxes will likely be increased by states. Are you aware of any property tax exemptions received by your competitors (or your business), if so how much revenue has been "lost" by Texas and its local governments from those exemptions?

Answer. I am unclear about this question because it is internally inconsistent.

I am unaware of property tax exemptions received by anyone in particular, but that has nothing to do with sales tax collection. The Texas Comptroller of Public Accounts has stated that Texas is losing about $750,000,000 a year in uncollected sales tax for Internet purchases.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. FRANK R. LAUTENBERG TO SCOTT PETERSON

Question 1. This year, my state of New Jersey will lose out on an estimated two hundred million dollars of sales taxes owed but not collected on out-of-state purchases. Do you believe it's feasible to collect sales taxes directly from residents who owe but haven't paid them?

Answer. No unless New Jersey imposes extraordinary requirements on its citizens. Because only the retailer and the consumer know anything about a purchase, New Jersey will have to presume that every citizen makes untaxed purchases. To collect that tax New Jersey will have to presume that every consumer filing an income tax owes use tax. Anyone who hasn't made an untaxed purchase will have to prove the negative. In addition to imposing this burden on its citizens it will not be able to collect the tax owed by people who do not file income tax returns as there is no feasible way of collecting from them. This will be the case for states without an income tax that have no feasible way of collecting their use tax.

Question 2. Of the forty-five states that levy sales taxes, only twenty have simplified their sales taxation by adopting the "Streamline Agreement." Why have so many states been unwilling to adopt these uniform standards?

Answer. Twenty-three have enacted all the simplifications. The others haven't for reasons that vary from old fashion politics to changes that would reduce current tax collections. Not every state is impacted the same from the Streamline simplification requirements and in a couple states adopting all the changes would reduce their current tax collections.

Question 3. My state of New Jersey has simplified its sales tax system to fully comply with the Streamline Agreement. But Senator Enzi's bill would authorize states that haven't met the Streamline Agreement standards to require New Jersey businesses to collect sales taxes for them. Could this uneven treatment put my state's businesses at a disadvantage?

Answer. The non-Streamline "alternative path" in Senator Enzi's legislation includes many of the critical simplifications found in the Streamline Agreement. Clearly, the more simplification requirements in the legislation the better it will be for New Jersey businesses as they start to collect sales tax in other states.

Question 4. I am concerned that the current approach to collecting sales taxes unfairly discriminates against low income individuals and the elderly. These individuals often lack Internet access, and cannot take advantage of online purchasing that is in effect tax-free. Would you agree that this makes our tax system more regressive?

Answer. Yes. Those without broadband Internet access or a credit card are at a serious disadvantage shopping on the Internet. It follows that those folks must make a greater percentage of their purchases locally, and all of those purchases will be fully taxed. Future sales tax regressivity studies will have to include access to broadband Internet service and access to a credit card, both of which are required for Internet shopping and less prevalent with the low income and the elderly.

WRITTEN QUESTIONS SUBMITTED BY HON. JIM DEMINT TO SCOTT PETERSON

Mr. Peterson is no longer employed with the Streamlined Sales Tax Governing Board, Inc., and did not respond to the Senator's written questions, submitted to Mr. Peterson after the hearing.

Question 1. The MFA would potentially subject South Carolina retailers to audits and tax enforcement actions by any state that complies with its criteria, even if South Carolina chooses not to. The MFA would therefore definitively increase regulation and impose new tax obligations on South Carolina businesses by states in which they have no physical presence or—more importantly—representation in government. Why do you think so many governors support legislation that allows the intrusion of other states' tax policies into their own? Do you believe states should be prohibited from imposing any taxes and regulations outside of their own borders? If not, which ones should be allowed?

Question 2. Aside from adding a line item on their tax forms, could you describe the efforts by state governments in the last year to improve enforcement of their use tax laws and the increased revenue from such efforts?

Question 3. What recourse will a South Carolina business have if they find themselves in a dispute with another states' department of revenue?

Question 4. Have you considered the option of allowing remote taxation only among and between those states that choose to comply with the MFA's criteria?

Question 5. In testimony before the Committee, one of the sponsors of the Marketplace Fairness Act indicated that taxation would be applied based on the credit card billing address of a purchaser. Do you believe this is accurate, and that the question of appropriate tax application is that simple?

Question 6. We have heard the term "showrooming" often spoken of in a negative way. It has been stated that consumers "showroom" in order to purchase from online sources primarily or exclusively to "avoid" paying sales tax. Do you think it is wrong that consumers are empowered by technology and retail competition to locate what they consider the best price for the product they seek? How often does "showrooming" lead to a purchase being made online, but from a source required to collect sales tax? Do you believe there are reasons other than sales tax collection that lead consumers to purchase from an online source versus a physical retailer?

Question 7. It has been stated that, without the interstate regulatory authority granted to states by the MFA, income and/or property taxes will likely be increased by states. Can you provide the Committee an idea of the aggregate amount of property tax exemptions received by retail establishments and commercial developers over the last decade and the related "lost" revenue to states and localities?

RESPONSE TO WRITTEN QUESTION SUBMITTED BY HON. FRANK R. LAUTENBERG TO STEVE DELBIANCO

Question. This year, my state of New Jersey will lose out on an estimated two hundred million dollars of sales taxes owed but not collected on out-of-state purchases. Do you believe it's feasible to collect sales taxes directly from residents who owe but haven't paid them?

Answer. New Jersey already makes it easy for taxpayers to self-report their unpaid sales tax on out-of-state purchases, as I describe below.

But even if taxpayers fail to comply, the good news is that New Jersey already collects a majority of sales taxes generated from e-commerce, and *all* of the top twenty e-retailers will be collecting for New Jersey by 2014, including Amazon. Of those companies who do not yet collect for New Jersey, the state need only focus on the top 500 e-retailers to capture over 90 percent of the uncollected tax revenue from e-commerce. That way, New Jersey businesses that sell to customers around the country could be protected from the high costs of collecting and filing taxes for up to 45 additional states.

New Jersey already makes it easy for residents to self-report their unpaid sales tax on out-of-state purchases.

New Jersey added a line on its individual tax return reminding taxpayers about their obligation to pay Use Tax on out-of-state purchases:

44. Use Tax Due on Out-of-State Purchases (See instruction page 38)
If no Use Tax, enter ZERO (0.00). ..... 44 , , .

In addition, New Jersey gives residents instructions when filling out their tax returns.[1] The tax form assists taxpayers by offering estimated Use Tax amounts for purchases made out of state, based on annual gross income. (see figure at right)

[1] State Of New Jersey Income Tax-Resident Return Instruction Booklet p.38–39

Line 44 - Use Tax Due on Out-of-State Purchases

Estimated Use Tax Chart
(for Step 1 computation **only**)

If your New Jersey gross income is:	Use Tax
up to $15,000	$ 7
$15,001 – $30,000	22
$30,001 – $50,000	32
$50,001 – $75,000	42
$75,001 – $100,000	53
$100,001 – $150,000	67
$150,001 – $200,000	85
$200,001 and over	.0426% (.000426) of income, or $247, whichever is less.

New Jersey already collects sales taxes on most e-commerce.

If self-reporting fails to capture most uncollected sales tax, New Jersey will soon be collecting the majority of sales taxes from e-commerce, as Amazon begins collecting sales taxes in 2014.

In fact, by 2014 *all* of the top 20 e-retailers will be collecting sales taxes for New Jersey. These businesses alone account for nearly 60 percent of all e-commerce. (see table at right)

Top 20 e-Retailers Collecting in NJ by 2014
Amazon.com
Staples Inc.
Apple Inc.
Walmart.com
Dell Inc.
Office Depot Inc.
Liberty Interactive Corp.
Sears Holding Corp.
Netflix Inc.
CDW Corp.
Best Buy Co.
OfficeMax Inc.
Newegg Inc.
Macy's Inc.
Sony Electronics Inc.
Costco Wholesale Corp.
LL Bean Inc.
Victoria's Secret Direct
JC Penny Co. Inc.
HP Home & Home Office

Amazon will soon collect in New Jersey—covering two-thirds of all the state's uncollected sales taxes from e-commerce

Amazon, which accounted for nearly two-thirds of all uncollected sales taxes from e-commerce in 2011, will begin collecting for New Jersey in 2014, since it will be opening a distribution center in the state.

Economists Eisenach and Litan[2] researched online sales tax collections and found that New Jersey's uncollected sales tax from e-commerce in 2012 is $152 million.

Of this $152 million, we estimate that Amazon constitutes almost two-thirds of those uncollected sales taxes.

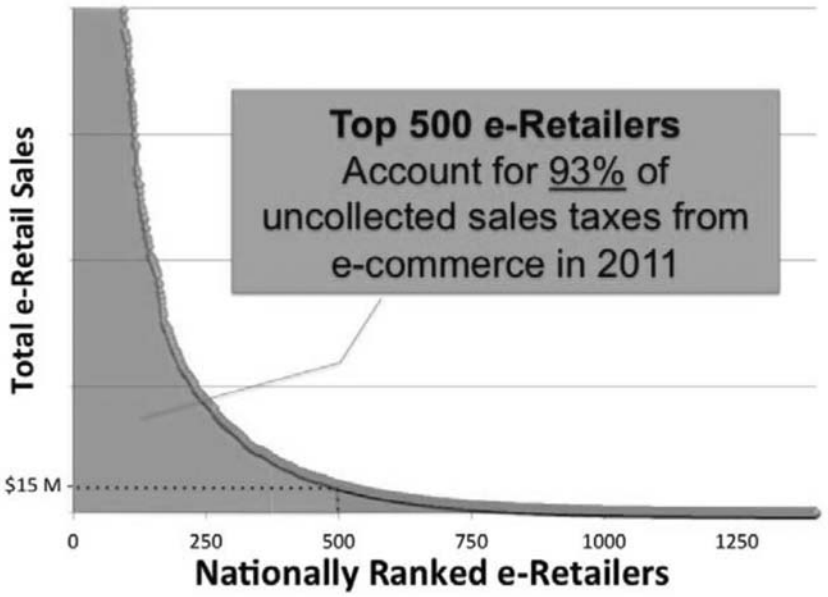
This means that when Amazon begins collecting sales taxes in New Jersey, they will collect $101 million of the $152 million leaving only $51 million in uncollected sales taxes.[3] Without any change in Federal law, New Jersey is already solving much of its uncollected sales tax problem.

Of the uncollected sales taxes from e-commerce in 2011, the top-500 e-retailers accounted for over 90 percent the non-collected taxes.

As I discussed in the hearing, it is unwise—and unnecessary—to burden small business with new costs of tax compliance, since most of the uncollected sales taxes come from the top-500 e-retailers—those with more than $15 million in annual revenue.[4]

This is especially important when you consider that small businesses are the most vulnerable to these new costs of collection, and as I showed in my testimony, this "free" software comes with additional costs and often does not work as advertised.

By focusing on those retailers at the top end of the graph below, states get most of the tax revenue while allowing smaller businesses to continue growing into larger ones.



The Internet is all of us, including small main street businesses in New Jersey

A "main street" store and a "remote seller" are often one in the same. Take for example Montclair Book Center in Montclair New Jersey.

This main street store is "one of the largest independent bookstores in New Jersey, with more than 15,000 square feet."

Montclair specializes in rare and out-of-print books and vinyl records.

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[2] Eisenach & Litan, *Uncollected Sales Taxes On Electronic Commerce: A Reality Check,* Empiris LLC (Feb. 2010), available at *http://bit.ly/EisenStudy.*

[3] This calculation is based on 2011 e-commerce figures. However, since Amazon's rate of growth was 41 percent in 2011, the amount of sales taxes that Amazon collects in 2014 will likely be much more than $101 million.

[4] Analysis based on: Top 500 e-Retailers and total e-commerce sales from Internet Retailer, *Top 500 Guide,* p. 32 (2012 Edition), and Top 500 e-retailer tax collection from Eisenach & Litan, *Uncollected Sales Taxes On Electronic Commerce: A Reality Check,* p.17, 25 (Feb. 2010), available at *bit.ly/EisenStudy*.

Beyond its main street presence, Montclair Book Center's website reaches customers from all states. And when fulfilling its online orders, Montclair Book Center does not collect sales taxes for any state other than New Jersey.

Select Shipping and Payment Method

Title/Author Name	Seller ID	Price
POCKET WATCHES : L'OROLOGIO DA TASCA LEONARDI, LEONARDO	2800811807533	6.50
	Subtotal:	6.50
	Tax:	0.00
	Total:	**6.50** USD

This is the type of business that would be most hurt if Congress forced all remote sellers to collect for all 46 states.

So when you think of "online sellers" please understand that term encompasses far more than just the top 20 e-retailers, all of whom will soon collect for New Jersey. Online sellers also include small New Jersey businesses like Montclair Book Center, who use the Internet to build their in-state income and employment.

Twelve Key Simplification Provisions For Federal Legislation on Remote Sales Tax Collection

If Congress were to force remote sellers to collect sales tax for all jurisdictions, any such legislation should contain the following simplifications:

1. States must provide certified software for rate lookup, collection, electronic filing, and funds transfer. Users of the software would be immune from state and civil liability for errors in taxes collected.
2. A single sales tax rate per state for remote sales, as was the original goal of the SSTP.
3. States should compensate businesses for reasonable costs of collecting sales taxes, including purchase and implementation of software.
4. A single set of definitions for taxable and exempt products for all states.
5. A single audit conducted by the retailer's home state on behalf of all states and local jurisdictions.
6. There should be a common sales tax return for remote sellers to file.
7. A single national rule for sourcing sales.
8. Harmonization of sales tax holidays and thresholds or optional remote seller exemption from participation in sales tax holidays and thresholds.
9. Allow remote sellers to challenge states in Federal district court for disputes on sales tax collection, including whether a state is following congressionally required simplifications.
10. Preemption and preclusion of state laws dealing with nexus for remote sellers.
11. Collection of sales tax under Federal legislation does not create nexus for any other business purpose.
12. A congressionally-determined exception for small businesses.

Summary

To summarize,

- New Jersey already takes steps to encourage and assist residents in remitting sales taxes on out-of-state purchases;
- New Jersey already collects a majority of sales taxes from e-commerce with all of the top twenty e-retailers collecting for New Jersey by 2014;
- Amazon will soon collect sales taxes for New Jersey; and
- Since over 90 percent of all uncollected sales taxes from e-retail sales come the largest of businesses it is unnecessary to saddle small businesses with the big costs of collecting sales taxes.

I am happy to answer any other questions you may have on this issue.

RESPONSE TO WRITTEN QUESTION SUBMITTED BY HON. MARK BEGICH TO STEVE DELBIANCO

Question. As a Senator of a rural state, I am truly amazed by the new opportunities Alaska businesses are able to enjoy through the use of the Internet. The Internet allows small businesses all across the country to access the global market and reach consumers in any corner of the world. For decades, only large businesses and corporations had access to the global market, but now small businesses have the opportunity to compete for those sales. However, I am concerned that the Internet sales tax proposal currently before the U.S. Senate might make it harder for small businesses to access these global opportunities. Forcing small businesses to collect in 9,600 tax jurisdictions nationwide will undoubtedly come with increased costs and legal liability. Can you elaborate on the potential costs and competitive disadvantages that would be associated with this type of change in law?

Answer. Senator, you are right to worry about the many small Alaska businesses that use the Internet to reach new customers. And a new tax collection burden falls hardest on small businesses—especially those in non-sales tax states like Alaska, where most businesses don't have the experience or systems to collect any sales taxes, let alone for 9,600 jurisdictions.

Examples of Challenges faced by Alaska businesses

Consider the example of Alaska Photo Graphics of Fairbanks. Created by an Alaskan photographer, this website sells large prints and beautiful calendars featuring Alaskan landscapes.

Another example is Oomingmak of Anchorage, who has been selling hand-knit Alaskan qiviut scarves and clothes since 1969.

Both these Alaskan businesses make their products available to customers in all fifty states via their online stores. However, neither business collects sales taxes for sales to any of these remote states.

Moreover, neither business collects for online sales shipped to customers in Alaskan cities that have a sales tax. This makes the burden of collecting for remote states even greater for Alaska Photo Graphics and Oomingmak, since they don't have the experience and systems to collect *any* sales taxes, let alone sales taxes for all 9,600 jurisdictions in 46 states.

Empirical study shows that small businesses spend 17 cents for every tax dollar they collect.

Aside from such anecdotal evidence, the Streamlined Sales Tax Project's own Cost of Collection[5] study found that a small business (under $1M in annual sales) spends 17 cents for every tax dollar it collects for states. And even if tax software works as promised, that only helps with 2 cents of the 17 cents in costs per dollar collected. *That leaves small businesses with a 15 percent cost burden on every dollar they collect,* for things such as:

- Paying computer consultants to integrate new tax software into their homegrown or customized systems for point-of-sale, web shopping cart, fulfillment, and accounting
- Training customer support and back-office staff
- Answering customer questions about taxability of items, or sales tax holidays
- Handling audit questions from 46 states
- Paying accountants and computer consultants to answer all these questions

These collection burdens will be a big problem for small businesses that collect only their home-state sales tax today. Ask any of your small business, on main street or online, and you'll learn how hard it would be for them to create systems to begin collecting sales tax all 46 states.

Online marketplaces may impose additional costs, up to 20 percent of sales

While Amazon says it will charge only about 3 percent for its tax collection services, Amazon won't collect taxes for a business unless the business *already* pays

[5] Available at *http://www.netchoice.org/wp-content/uploads/cost-of-collection-study-sstp.pdf*

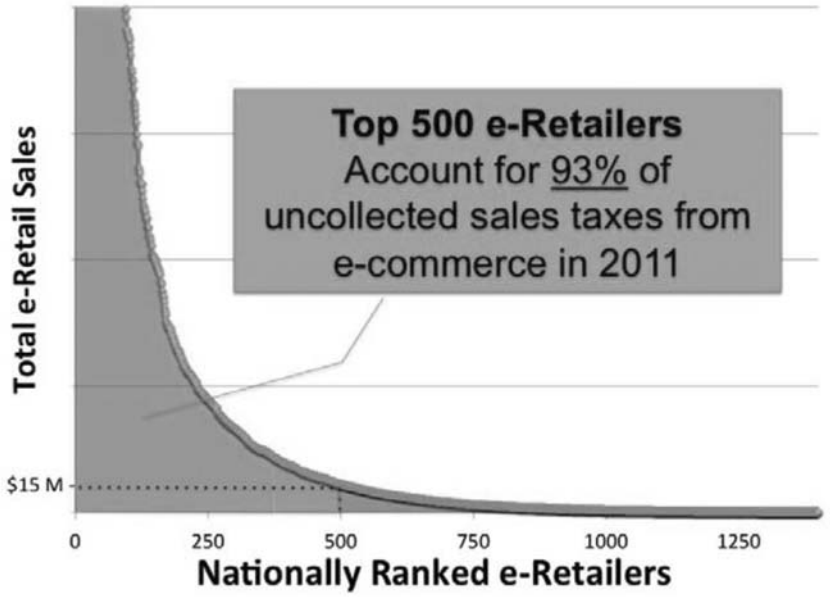
Amazon to host its web store—for that, *Amazon charges a referral fee of 10–20 percent of the sale proceeds, plus additional fees.*[6]

So small businesses using Amazon's tax collection services might pay up to 20 percent of their sale proceeds, leaving little to pay employees and expand their business. And it increases the small business' reliance on expensive and established online marketplaces.

Congress should exempt businesses with less than $15 million in annual sales from any new tax collection mandate for out-of-state sales.

One way to set a realistic small seller exception is to exempt all businesses that are out on the "long tail" in terms of e-retail sales. For example, *Internet Retailer* publishes a *Top 500 Guide* each year, ranking the Nation's largest retailers on their U.S. e-commerce sales. For 2011, the #1 e-retailer was Amazon.com, at $48 billion in e-retail sales. Number 500 had just $15 million in remote e-retail sales. In total, the Top 500 had $181 billion in e-retail sales.

Economists Eisenach and Litan started with this Top 500 Guide when analyzing where each retailer already collected sales tax under *Quill*'s physical presence standard. Using their analysis, we estimated that the Top 500 were responsible for 93 percent of the uncollected sales tax on U.S. e-commerce in 2011, as shown in the graph below[7] (*netchoice.org/top500collect*).



Congress could set a small seller exception that adjusts with inflation and retail trends by exempting sellers below the Top 500 cutoff from the previous year. Under this method, *the small seller exception for 2012 would have been $15 million in annual sales.* That would leave exempted retailers with a more reasonable gross margin to cover expenses, *while allowing states to recover over 90 percent of the uncollected sales tax on e-retail.*

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[6] Amazon Service Fees, *http://www.amazonservices.com/sell-on-amazon/media-fees.htm/ref=amb_link_356743102_18?ie=UTF8&pf_rd_m=A2CA1KKALKCX2O&pf_rd_s=top-1&pf_rd_r=11SNTTXVHCER4S0J4KNK&pf_rd_p=1328499722&pf_rd_t=101&pf_rd_i=soa-faq-detail&ld=AZFSSOAAS*

[7] Top 500 e-Retailers and total e-commerce sales from Internet Retailer, Top 500 Guide, p. 32 (2012 Edition). Top 500 e-retailer tax collection from Eisenach & Litan, Uncollected Sales Taxes On Electronic Commerce: A Reality Check, p. 17, 25 (Feb. 2010), available at *http://bit.ly/EisenStudy*

Twelve Key Simplification Provisions For Federal Legislation on Remote Sales Tax Collection

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1. States must provide certified software for rate lookup, collection, electronic filing, and funds transfer. Users of the software would be immune from state and civil liability for errors in taxes collected.
2. A single sales tax rate per state for remote sales, as was the original goal of the SSTP.
3. States should compensate businesses for reasonable costs of collecting sales taxes, including purchase and implementation of software.
4. A single set of definitions for taxable and exempt products for all states.
5. A single audit conducted by the retailer's home state on behalf of all states and local jurisdictions.
6. There should be a common sales tax return for remote sellers to file.
7. A single national rule for sourcing sales.
8. Harmonization of sales tax holidays and thresholds or optional remote seller exemption from participation in sales tax holidays and thresholds.
9. Allow remote sellers to challenge states in Federal district court for disputes on sales tax collection, including whether a state is following congressionally required simplifications.
10. Preemption and preclusion of state laws dealing with nexus for remote sellers.
11. Collection of sales tax under Federal legislation does not create nexus for any other business purpose.
12. A congressionally-determined exception for small businesses.

Summary

Senator, you are right to be concerned about the small businesses that will be hit hardest by these new tax collection burdens. And we should also consider the anti-competitive nature of forcing small growing businesses to rely on their large and established competitors for tax collection services. However, by setting a robust Congressionally-mandated small seller threshold along with the other minimum simplifications listed here, we can protect all Alaska businesses from the high burdens of collection.

I am happy to answer any other questions you may have on this issue.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. JIM DEMINT TO STEVE DELBIANCO

Question 1. If we give states this new taxing power on the basis that they simplify their tax codes, how do we make sure states stick to the simplification, and what do we do if the costs to businesses turn out to be much higher than we're being told today?

Answer. Naturally, state tax collectors would prefer new tax revenue without undertaking any simplification or standardization of their tax systems. This is why, as you correctly identified, there are two necessary components to legislation that grants new taxing powers: simplicity and accountability.

Minimum Simplifications

Because of the new tax burdens of compliance, previous congressional legislation to overturn *Quill* included as many as 16 minimum simplification requirements that SSTP states would have to honor. Congress should continue to mandate simplification in any bill that overturns *Quill.*

To that end, we developed the following list of minimum simplifications that mitigates some of the new tax burdens imposed by legislation such as the MFA.

- Remote retailers should *not* be subject to audits from 46 separate state tax authorities. States should respect the outcome of a single audit by any state, on behalf of *all* states.
- Remote retailers should be allowed to use a single sales tax rate for remote sales made into each state, which was the original goal of the SSTP. State lawmakers would, of course, be able to allocate sales tax proceeds among local jurisdictions.

- States should be required to adopt a single set of definitions for taxable and exempt products across *all* states.
- States should compensate all businesses for the fair and reasonable cost of collecting sales taxes, taking into account such elements as credit card fees and costs of software implementation and maintenance. Compensation was required in previous Federal legislation to overturn the *Quill* physical presence standard, but was dropped in recent versions.
- Remote businesses should not be required to file sales tax returns for all 46 states. All states should accept a single sales tax return filed with a business' home state. The home state revenue department would be responsible for distributing funds to remote states.
- Remote retailers should not be *required* to honor, but may observe, thresholds for sales tax calculation. (an example of a threshold is Massachusetts, where the first $175 of any clothing item is exempt from sales tax.[1])
- Remote retailers should not be *required* to honor state-specific sales tax holidays.
- States should be required to adopt a single rule for sourcing sales. The SSTP originally maintained destination sourcing for all sales tax transactions. But to accommodate origin-based states, SSTP's Governing Board voted to allow origin sourcing for in-state sales while requiring destination sourcing for remote sales. Such "dual sourcing" should not be permitted as part of any Federal legislation overturning the physical presence standard.
- States must provide certified software for collection, filing, and remittance of taxes. Some proposed legislation requires only that states provide software "that identifies the applicable destination rate". That leaves remote businesses to bear the full cost of integrating the rate lookup into their in-house systems and processes. And the business would also have to pay for software to handle filing and remittance in 46 different states.

Once Congress has dictated the minimum simplifications, the next challenge is how to hold participating states accountable for compliance. We recommend two ways to achieve compliance: the ability to challenge states in Federal district court; and creating a multi-state compact instead of a nationwide tax mandate.

Challenges in Federal District Court

Remote-seller tax legislation must include a mechanism for businesses to challenge a state in Federal district court if the state fails to comply with the statutory minimum simplifications. But under the Tax Injunction Act (28 U.S.C. § 1341), taxpayers are forced to use *state* courts to litigate disputes with state tax collection authorities, even on questions of whether a remote state is following Federal law.

To ensure that states stick with required simplifications, Federal district courts should have jurisdiction over disputes arising between states and remote businesses regarding a state's compliance with Federal law.

Multi-State Compact

Congress should retain the benefits of market discipline to restrain states from expanding the complexity of their sales tax systems and skirting the minimum simplification requirements. Fortunately, Congress has a simple way to enforce "tax competition" as part of any legislation that overturns the physical presence standard: *Congress could authorize remote collections through a multi-state compact instead of a national mandate on* ***all*** *businesses.*

Proposed legislation to overturn *Quill* would impose collection burdens on businesses in *all 50 states*—including businesses in states that don't even have a sales tax. Lawmakers in all 50 states would lose the sovereign right to protect their citizens and businesses from tax burdens imposed by other states.

If these new collection burdens are hurting businesses in a state, their own legislators won't be able to rescue those businesses if Congress makes collection mandatory for all. This comes as a surprise to many lawmakers who are beginning to understand the impact of a national mandate ironically described by advocates as supporting states' rights.

Contrast the national mandate in S. 1832 with a multi-state compact, where states could opt-in if they believed new tax revenues justified forcing their in-state business collect taxes for other states in the compact. By the same token, states could *opt-out* of the compact if remote state tax burdens were excessive. States opt-

[1] Mass. Dept. of Revenue, *A Guide to Sales and Use Tax, http://www.mass.gov/dor/individuals/taxpayer-help-and-resources/tax-guides/salesuse-tax-guide.html#apparel*

ing-out would lose the power to force remote sellers to pay their sales tax, but at least states could protect their own businesses from unreasonable burdens on interstate commerce.

Question 2. Have you considered the option of allowing remote taxation only among and between those states that choose to comply with the MFA's criteria?

Answer. We support a multi-state compact as the best way to ensure compliance and preserve states' rights. By treating the MFA as a multi-state compact as opposed to a mandate, states maintain sovereignty over their taxes and protect their own businesses from tax collection obligations imposed by other states. In addition, states within the compact must achieve and maintain simplicity to encourage adoption and continued membership in the compact.

With a multi-state compact, Congress can maintain states' rights while retaining the benefits of market discipline to restrain states from expanding the complexity of their sales tax systems. To that end, Congress has a simple way to enforce "tax competition" as part of any legislation that overturns the physical presence standard: *Congress could authorize remote collections through a multi-state compact instead of a national mandate on* ***all*** *businesses.*

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Contrast the national mandate in S. 1832 with a multi-state compact, where states could opt-in if they believed new tax revenues justified having their in-state business collect taxes for other states in the compact. By the same token, states could *opt-out* of the compact if remote state tax burdens were excessive. States opting-out would lose the power to force remote sellers to pay their sales tax, but at least states could protect their own businesses from unreasonable burdens on interstate commerce.

For example, suppose South Carolina decided to opt-in to a multi-state tax compact. If, after many months of collecting new taxes, South Carolina businesses begin complaining of the costs of collecting and filing for 45 other states, South Carolina can then opt-out of the compact. South Carolina would no longer receive the additional tax revenue, but it would retain its sovereign right to protect its in-state businesses from other states' tax collectors.

Moreover, the multi-state compact becomes a test of whether the benefits of new taxes outweigh the compliance costs on local businesses. If MFA advocates are correct in their belief that compliance costs will be minimal, states would rush to join a Congressionally-endorsed tax compact. In the end, if the MFA advocates are correct, all 46 tax states would join the compact thereby requiring their states' businesses to collect and remit to the other compact states.

Question 3. In testimony before the Committee, one of the sponsors of the Marketplace Fairness Act indicated that taxation would be applied based on the credit card billing address of a purchaser. Do you believe this is accurate, and that the question of appropriate tax application is that simple?

Answer. The Marketplace Fairness Act uses a layered approach in determining the appropriate tax jurisdiction. However, the steps of determining tax jurisdiction and rate are only a small part of the costs of compliance for businesses.

The MFA first attempts to apply taxes based on the shipping address, or destination. If shipping address is not applicable (such as for digital media delivered by download), the tax is sourced to the customer's billing address. Finally, if billing address is unknown, the transaction is sourced to the shipper's address.[2]

Once sourcing is determined, the applicable tax rate can be found through a database lookup function, taking into account the date, sale amount, and product/service category. If the lookup software works as advertised, determining the appropriate tax rate is relatively easy. But identifying the applicable tax rates is only a small part of the new costs that a business would face under the MFA or similar legislation.

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[2] Marketplace Fairness Act § 6(8).

The SST's own Cost of Collection[3] study found that a small business (under $1 million in annual sales) currently spends 17 cents for every tax dollar it collects for states. And even if tax software works as promised, that only helps with 2 cents of the 17 cents in costs per dollar collected. *That leaves small businesses with a 15 percent cost burden on every dollar they collect* for things such as:

- Paying computer consultants to integrate new tax software into their home-grown or customized systems for point-of-sale, web shopping cart, fulfillment, and accounting
- Training customer support and back-office staff
- Answering customer questions about taxability of items or sales tax holidays
- Handling audit questions from 46 states
- Paying accountants and computer consultants to answer all these questions

These collection burdens will be a big problem for small catalog and online businesses that collect only their home state sales tax today. Ask any small business, on Main Street or online, and you'll learn it's hard enough to collect sales tax for one state, let alone all 46 states with sales tax laws of their own.

One of the most significant costs and challenges for remote retailers is integrating tax rate lookup software into their in-house information systems. This point was demonstrated when the Silver Gallery explained to the Streamlined Sales Tax Governing Board how they would incur nearly $22,000 in costs for design, programming, integration, testing, and employee training. This cost estimate was developed for the task of integrating "free" software into Silver Gallery's existing information systems.

Sourcing and rate lookup are only a small part of the costs of compliance imposed by the MFA.

Question 4. We have heard the term "showrooming" often spoken of in a negative way. It has been stated that consumers "showroom" in order to purchase from online sources primarily or exclusively to "avoid" paying sales tax.

Question 4a. Do you think it is wrong that consumers are empowered by technology and retail competition to locate what they consider the best price for the product they seek?

Answer. Empowering consumers through technology is a net positive, since it encourages competition among businesses and saves consumers money.

However, shoppers don't always walk out of a store just to get a lower price at a different store or website. Many other factors come into play, including convenience, features, color, size, and service.

For example, surveys show that the top consideration for people shopping online is *free shipping,*[4] so consumers are not likely to leave a store and buy online if they have to pay additional costs for shipping.

Even when prices are lower online, sixty percent of Americans still prefer to make purchases in-store rather than go online.[5] And it's essential to remember that 93 percent of retail sales are still done in stores.[6]

This makes sense, since shoppers buying in stores enjoy the instant gratification of taking the item home instead of waiting for a delivery to arrive days later. And of course, returns and exchanges are far easier in store, compared to having to package and stand in line at the post-office to return items bought online.

For American consumers who prefer online shopping, retailers are offering a "brick and click" model that provides the benefits of online research and selection along with the convenience of in-store pickups, exchanges, and returns. Under this new model, Wal-Mart allows customers to buy online at WalMart.com and then pick-up and return in store (WalMart.com is now the Nation's fourth largest e-retailer[7]). Many other retail stores set-up in-store kiosks so shoppers can easily order online products that may be unavailable in the store.

While it is beneficial to empower consumers and encourage price competition, businesses are not competing on price alone.

Question 4b. How often does "showrooming" lead to a purchase being made online, but from a source required to collect sales tax?

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[3] Price Waterhouse Coopers, *Retail Sales Tax Compliance Costs: A National Estimate,* available at *http://www.netchoice.org/wp-content/uploads/cost-of-collection-study-sstp.pdf.*

[4] Kantar Media Complete, *The State of Online Retail* (Sept. 13, 2011)

[5] MarketingCharts (Dec. 6, 2012), available at *Khttp://www.marketingcharts.com/wp/interactive/6-in-10-americans-prefer-shopping-in-store-to-buying-online-25244*

[6] Forrester Research: Web-Influenced Retail Sales Forecast, 2010–2015 (US).

[7] Top 500 e-Retailers and total e-commerce sales from Internet Retailer, Top 500 Guide, p. 32 (2012 Edition).

Answer. Evidence of showrooming is anecdotal and we have not yet seen any data indicate the frequency with which it occurs.

But when showrooming does happen, buyers are increasingly turning to an e-retailer that already collects taxes. In 2011, 18 of the top 20 e-retailers collected for 38 states.[8] These top e-retailers included many big box stores: Staples.com Walmart.com, OfficeDepot.com and BestBuy.com.

At the top of the list is Amazon.com with 25 percent of total U.S. e-commerce.[9] However, by the end of next year, Amazon will be collecting for over half the country. And as Amazon moves to a same day-delivery model, it will continue increasing the number of states in which it has a distribution center and thus increasing the number of states for whom Amazon must collect.

An often-ignored aspect of online retail is "reverse showrooming" where online stores influence in-store purchases. More and more shoppers are doing Internet research before their in-store purchases—relying on online retail sites' descriptions and reviews. Over the next year, in-store sales influenced by online research is expected to rise by $120 billion to $1.2 trillion.[10]

It would seem that in the end, most taxes from online sales, whether compelled by showrooming or not, will be collected.

Question 4c. Do you believe there are reasons other than sales tax collection that lead consumers to purchase from an online source versus a physical retailer?

Answer. There are many factors that lead a consumer to shop online, such as convenience, selection, lower prices, and the ease of finding research and reviews. Online shopping provides in-depth product information and reviews, eliminates having to drive to the store or deal with long checkout lines, and lets buyers have hard-to-carry items delivered to their doorstep.

While sales taxes may be a factor, we have not seen any data showing that consumers shop online in order to avoid paying sales taxes. Taxes are just part of the total cost of a product, and only one factor among many that would lead a consumer to shop online.

These non-price factors are driving more and more people to shop online. More and more sales are occurring through e-retailers who already collect sales taxes, including Staples.com Walmart.com, OfficeDepot.com and BestBuy.com.[11]

As evidence that sales tax avoidance is not a major driver of online sales, consider the case of Amazon.com in the growing list of states where it collects sales tax.

In a conference call with equity analysts on July 26, 2012, Amazon executives fielded questions about the sales impact of collecting sales tax in more and more states. The company's CFO said:

> *"We have also certainly added some new geographies or new jurisdictions that we clocked during that time period. But you see that we have seen very very strong growth even while collecting."*[12]

There's additional evidence that sales tax is not the driving factor for buying on Amzon.com. Amazon began collecting sales tax in California on September 15, 2012 because it has physical presence there with its Kindle labs and new distribution centers. Even though customers in one of Amazon's largest markets saw an 8 percent effective price increase, the company did not warn analysts about any impending drop in sales.

On Amazon's October 25, 2012 conference call to discuss Q3 results, an analyst asked,

> "I know it's early, but is there a noticeable impact on sales of having to collect sales tax in California?"

Amazon's CFO replied,

> "You're right that it's early. The only thing I can say is that we collect sales tax or value-added tax on over 50 percent of our revenue today. We have very good businesses in those states and geographies where we do collect."[13]

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[8] *Id.*

[9] *Id.*

[10] Forrester Research: Web-Influenced Retail Sales Forecast, 2010–2015 (U.S.).

[11] Top 500 e-Retailers and total e-commerce sales from Internet Retailer, Top 500 Guide, p. 32 (2012 Edition).

[12] Tom Szkutak, CFO, in a transcript of Amazon's Q2 2012 Earnings Call, *http://seekingalpha.com/article/754571-amazon-com-s-management-discusses-q2–2012-results-earnings-call-transcript?part=single*

[13] Amazon, *Q3 2012 Amazon.com Inc Earnings Conference Call,* available at *http://phx.corporate-ir.net/phoenix.zhtml?p=irol-eventDetails&c=97664&eventID=4849777*

This helps demonstrate our contention that American consumers go online seeking better selection, convenience, and lower prices—they don't shop online to avoid paying sales taxes.

Question 5. It has been stated that, without the interstate regulatory authority granted to states by the MFA, income and/or property taxes will likely be increased by states. Can you provide the Committee an idea of the aggregate amount of property tax exemptions received by retail establishments and commercial developers over the last decade and the related "lost" revenue to states and localities?

Answer. It should first be noted that the amount of new tax revenue that would come from bills like the MFA is grossly over-stated. A simple calculation using government data shows that the maximum sales tax potential for consumer e-commerce *is less than one percent of total state and local tax revenue:*

Start with the U.S. Department of Commerce's *2010 Electronic Commerce Industry Assessment,* which reported total retail e-commerce of $169 billion.[14]

Apply an average tax rate of 7 percent, giving total potential sales tax of $11.8 billion.

Divide that by total state and local tax revenue in 2010, reported as $1.3 trillion by the Commerce Department.[15]

The result is clear: the maximum potential sales tax on all e-commerce is less than one percent of state & local tax revenue—*assuming that no sales taxes are collected by e-retailers.*

But under today's *Quill* standard, e-retailers already collect sales tax for states where they have physical presence. NetChoice commissioned a study by economists Robert Litan and Jeffrey Eisenach to determine where e-retailers were already collecting sales tax for web sales.

They concluded that uncollected sales tax on e-commerce in 2010 was $4.2 billion nationwide, or *less than one-third of one percent of total state and local tax revenue.*[16] This relatively small incremental revenue does not justify a dramatic expansion of state taxing powers and new collection burdens on remote businesses.

Second, as you correctly noted, state and local governments often provide incentives and benefits to in-state retailers, such as tax increment financing, transportation improvements, worker training subsidies, grants, tax credits, property and income tax incentives, etc. None of these benefits are available to out-of-state businesses.

While we do not have specific data on the total "lost" revenue, we can provide the following examples of state benefits:

- In January 2002, the State of Maine agreed to provide Wal-Mart with $16.7 million in subsidies. In return, Wal-Mart decided to build a 480,000 square foot distribution center in Lewiston.
- In 2003, Millerville, NJ agreed to provide Target with $1 million toward the costs of improving existing infrastructures for the under-developed area for a new Target store.
- And most recently we have seen examples of tax forgiveness and deferrals of tax obligations given to Amazon for the construction and continued operation of distribution centers in Pennsylvania, Virginia, and Texas.

Please note that NetChoice respects the rights of states to offer incentives to businesses as the states expect to gain new jobs and associated tax revenue.

Nonetheless, when weighing benefits and burdens of Main Street versus the Internet, we ask Congress remember that brick-and-mortar stores enjoy significant service and tax benefits—benefits not available to out-of-state retailers.

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[14] U.S. Census Bureau E-Stats, *http://www.census.gov/econ/estats/2010/2010reportfinal.pdf*

[15] *Id.*

[16] Eisenach & Litan, *Uncollected Sales Taxes On Electronic Commerce: A Reality Check,* Empiris LLC (Feb. 2010), available at *http://bit.ly/EisenStudy*