EXPLORING ALTERNATIVE SOLUTIONS ON THE INTERNET SALES TAX ISSUE

HEARING

BEFORE THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRTEENTH CONGRESS

SECOND SESSION

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EXPLORING ALTERNATIVE SOLUTIONS ON THE INTERNET SALES TAX ISSUE

WEDNESDAY, MARCH 12, 2014

HOUSE OF REPRESENTATIVES
COMMITTEE ON THE JUDICIARY
Washington, DC.

The Committee met, pursuant to call, at 10:08 a.m., in room 2141, Rayburn Office Building, the Honorable Bob Goodlatte (Chairman of the Committee) presiding.

Present: Representatives Goodlatte, Coble, Smith of Texas, Chabot, Bachus, Issa, Forbes, King, Franks, Gohmert, Jordan, Poe, Chaffetz, Marino, Gowdy, Labrador, Farenthold, Holding, Collins, DeSantis, Smith of Missouri, Conyers, Nadler, Scott, Lofgren, Jackson Lee, Cohen, Johnson, Pierluisi, Chu, Deutch, Bass, Richmond, DelBene, Garcia, Jeffries, and Cicilline.

Staff present: (Majority) Shelley Husband, Chief of Staff & General Counsel; Branden Ritchie, Deputy Chief of Staff & Chief Counsel; Allison Halataei, Parliamentarian and General Counsel; Daniel Huff, Counsel; Kelsey Deterding, Clerk; (Minority) Perry Apelbaum, Minority Staff Director & Chief Counsel; Danielle Brown, Parliamentarian; and Norberto Salinas, Counsel.

Mr. GOODLATTE. Good morning. The Judiciary Committee will come to order. And without objection, the Chair is authorized to declare recesses of the Committee at any time.

We welcome everyone to this morning's hearing on exploring alternative solutions on the internet sales tax issue. And we will take note that this morning Sir Tim Berners-Lee, who is widely credited as being the inventor of the worldwide web, announced that today is the 25th anniversary of the internet, so we will take note of that as well. I think Sir Tim Berners-Lee has more credibility on the issue.

I will recognize myself for an opening statement.

Over the last 3 years, shopping center foot traffic has fallen 50 percent. In January, JC Penney announced it would close 33 stores and cut 2,000 positions. Radio Shack is shuttering about 500 retail stores nationwide. Most recently, Staples announced that it will close 225 stores over the next year.

Meanwhile, internet commerce is booming. Fourth quarter U.S. retail e-commerce sales were $69.2 billion, up 16 percent from the same period in 2012. With e-commerce just 6 percent of total retail sales, there is much room for continued rapid growth. In part,

these trends reflect structural advantages internet retailers enjoy, like lower store overhead.

Congress should not interfere in the natural evolution of the markets. However, many argue that unfair sales tax laws are contributing to these trends. Congress should examine this problem and potential solutions.

In *Quill v. North Dakota*, the Supreme Court reaffirmed a long-standing rule: sellers cannot be forced to collect sales taxes for States in which they have no physical presence because compliance would unduly burden interstate commerce. The commerce clause requires physical presence in order to address structural concerns about the effects of State regulation on the national economy.

Under the Articles of Confederation, State taxes had hindered interstate commerce, and the commerce clause sought to remedy such burdensome State laws. However, the Supreme Court has also indicated that Congress has the ability to relax the physical presence test if Congress determines that there is no longer a burden on interstate commerce by the State activity in question.

Traditional retailers argue that the physical presence test puts them at a distinct disadvantage to their online counterparts who do not collect sales tax. Numerous retailers have brought Congress personal examples of what they call show rooming. Consumers go to a store, draw on the retailer's knowledge, and then buy the item online specifically to save the sales tax.

Technically, consumers in the 45 States with a sales tax still owe it if it is not collected by the seller. This nearly identical obligation is known as a use tax. However, it is widely ignored by consumers and unenforced by States for both practical and political reasons. States estimate the annual lost revenue at $23 billion.

The Senate solution to this problem, the Marketplace Fairness Act, ostensibly lets states that simplify their tax rules force remote sellers to collect. In practice, the bill suffers from fundamental defects in 3 categories. First, the tax is already owed, but the public still views the bill as Congress taxing the internet. In a June 2013 Gallup poll, 57 percent of Americans opposed it. Opposition among young voters was 73 percent.

Second, compliance was not sufficiently simple. The bill required states to provide free software, but did not address integration costs. Furthermore, compliance software does not help the direct mail industry, and the bill provides no method for handling use-based exemptions common in agriculture and medical device sales.

Other complications abound. Compliance costs estimates vary widely. There are over 9,600 taxing jurisdiction, and the Affordable Care Act experience has left voters wary of highly-touted software solutions.

One of the most significant defects is that the bill exposes remote sellers to multiple audits in jurisdictions in which they have no voice. Legislators prefer to impose taxing burdens on those least able to hold them accountable. That is why hotel taxes are so high—18.27 percent in Manhattan. These taxes fall primarily on out of towners who cannot vote. Similarly, remote sellers have no direct recourse to protest unfair or unwise enforcement, making them prime targets.

That said, the Committee is sympathetic to the plight of traditional retailers. It is serious about searching for a solution that the various parties can accept. The issue is just far more complex than it seems at first glance. If Congress is to act, it must do so deliberately and precisely to avoid a cacophony of 9,600 taxing jurisdictions fighting over what is required.

Accordingly, on September 18, 2013, the Judiciary Committee published seven principles regarding remote sales tax. The principles were intended to spark fresh, creative solutions. In the months following, the Committee received a number of ideas in response to the principles.

This hearing will examine these ideas in depth. One witness representing each idea the Committee would like to explore will advocate for it and defend it against criticisms from fellow panelists. The merits and shortcomings of each approach will be exposed. The aim is to start winnowing down the proposals to see if there are any that can garner support from all sides.

There have been more than 30 congressional hearings on this issue since 1994. New approaches are needed, and these witnesses will present some today. I look forward to their testimony and ask everyone to keep an open mind, and hope no one finds today's proceedings too taxing. [Laughter.]

And it is now my pleasure to recognize the gentleman from Michigan, the Ranking Member of the Committee, Mr. Conyers, for his opening statement.

Mr. CONYERS. Thank you, Chairman Goodlatte, and Members of the Committee, and our distinguished witnesses, including a former Member. Today's hearing focuses on alternatives to those prior legislative initiatives, and I welcome the discussion on these ideas.

State governments rely on sales and use taxes for nearly one-third of their total tax revenue. Yet as more Americans purchase more of their goods on the internet, the State receives less in sales tax revenue. For example, in my State of Michigan, the Department of Treasury estimates the total revenue lost to remote sales will total $290 million this Fiscal Year.

Lost tax revenues mean that State and local governments will have fewer resources to provide their residents essential services, like education, and police, and fire protection. It also means fewer funds to pay for basic necessities, like salt to melt the ice and snow and asphalt to fill the potholes.

Uncollected sales taxes also have a negative impact on our local communities. Fewer purchases at local retailers obviously translate to fewer local jobs, and eventually the closing of stores. The unfair advantage that remote sellers have by not collecting sales taxes hurts us all.

Congress should not delay any further.

In its 1992 *Quill* decision already referred to by the Chairman, the Supreme Court recognized that Congress is best suited to determine whether a remote seller must collect sales taxes. Congress has yet to make that critical determination. And so we owe it to our local communities, our local retailers, and State and local governments to act before the end of this year.

I am pleased that today's hearing provides us the opportunity to take that next step toward resolving this issue. Although I would prefer to mark up the Senate-passed Marketplace Fairness Act and to consider amendments to further improve it, I welcome the opportunity to hear workable alternative proposals. This issue is a prime opportunity for all of us to work on a bipartisan basis on legislation, but it is imperative that we do so this year.

So I thank Chairman Goodlatte for holding this hearing today, and I stand ready to work with him and all Members of this Committee to move legislation through this Congress. But we should not delay any further. Thank you. That concludes my statement.

Mr. GOODLATTE. Thank you, Mr. Conyers. I appreciate the good bipartisan work that has gone into this effort thus far, and we look forward to continuing that.

Before we hear from our witnesses, I am going to ask unanimous consent to insert in the record a series of letters sent to the Committee in advance of the hearing. Many folks have wanted to testify. There are limits on the numbers who could. Some of these letters are in favor of particular approaches, others are opposed, but all are generally supportive of the process the Committee has put in place.

They are from the Cigar Association of America; the Consumer Electronics Association; the International Council of Shopping Centers; the Streamline Sales Tax Governing Board; the National Association of Electrical Distributors; the National Association of Realtors; the Agricultural Retailers Association and National Council of Farmers Cooperatives; Amazon.com; the City of Plano; National Association of Real Estate Investment Trusts; and the National Retail Federation.

Without objection, they will all be inserted into the record.

[The information referred to follows:]

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The Honorable Robert William Goodlatte
Chairman, House Judiciary Committee
U.S. House of Representatives
Washington, DC 20515

March 5, 2014

Dear Mr. Chairman:

I am writing on behalf of the Cigar Association of America, a national organization representing cigar manufacturers, importers, distributors, and other major industry suppliers, to ask that you oppose H.R.684, the Marketplace Fairness Act. We believe that this bill, which represents a multi-million dollar tax hike, would deal an unprecedented blow to both the cigar industry and the economy at large.

Online commerce is a vital fuel that helps power the American economy. The Marketplace Fairness Act would have a direct and negative effect on the profitability of online businesses, forcing them to make massive investments to comply with the law at the same time they are losing sales and jobs.

Brick-and-mortar stores have been advocating for the Marketplace Fairness Act because they claim current tax laws offer online retailers an unfair advantage. Yet under the Marketplace Fairness Act, online retailers would face significant compliance burdens that will not affect traditional retailers. For example, there are more than 10,000 state and local taxing jurisdictions in America, which would create an extremely costly and complicated nightmare of red tape for online retailers. In addition, online retailers would face constant threats of audits, fines, and penalties from multiple states.

If passed, the Marketplace Fairness Act would directly oppose the Commerce and Due Process Clause in the U.S. Constitution, which "prohibits certain state actions that interfere with interstate commerce." In the U.S. Supreme Court case of *Quill v. North Dakota* (1992), the Supreme Court affirmed that state attempts to tax businesses with no substantive physical presence within their borders constituted an illegal interference.

The Marketplace Fairness Act would place crippling burdens on interstate commerce, and would negatively affect thousands of businesses. The bill would be especially damaging to the $6 billion cigar industry, which employs tens of thousands of workers in America and abroad. If the Marketplace Fairness Act becomes law, we expect to lose 50 percent of our sales of premium cigars, and many jobs along with it.

For many online businesses, the Marketplace Fairness Act will mean the difference between operating profitably and closing shop. We are asking you to stand up for real fairness for business owners and consumers and to defeat this blatant attack on American online commerce.

Sincerely,

Craig P. Williamson

Craig Williamson
President, Cigar Association of America

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March 12, 2014

The Honorable Robert Goodlatte
Chair
Committee on the Judiciary
U.S. House of Representatives
Washington, DC 20515

The Honorable John Conyers, Jr.
Ranking Member
Committee on the Judiciary
U.S. House of Representative
Washington, DC 20151

Dear Chairman Goodlatte and Ranking Member Conyers:

On behalf of the Consumer Electronics Association (CEA), I write to thank you for your leadership and commitment to addressing the collection of sales taxes on products purchased online and commend today's hearing entitled, "Exploring Alternative Solutions on the Internet Sales Tax Issue." The collection of Internet sales tax is not a problem just impacting retailers, but it is also harming states and localities that have suffered $23 billion in lost sales tax revenue.

CEA is the preeminent trade association representing American innovators and entrepreneurs, both large and small, who are consumer technology companies. CEA's over 2,000 corporate members include manufacturers, Internet providers, and large and small retailers. Our members design, produce and sell products and provide services that enable millions upon millions of consumers every day to access the wonders of the Internet.

We applaud today's hearing exploring the collection of sales tax and believe it represents a strong step forward to realizing a solution. As you know, the current collection system is harming local businesses and is fostering an inequality in the marketplace that is fundamentally unsustainable. In fact, this year hundreds of local stores across the Unites States announced that they would be closing their doors. Further, it is placing states and localities in a financial bind potentially affecting vital government services, like fire and police, as state and local tax revenues decline.

At a time when companies are already struggling to hire and survive, it's important that we support them by implementing a measure that will increase competition, help create revenue and prevent unnecessary enforcement.

We look forward to working with your staff and the Committee on developing legislation based on the principles outlined last September and the solutions discussed during today's hearing.

Thank you for your time and consideration.

Sincerely,

Gary S. Shapiro
President & CEO

International Council of Shopping Centers, Inc.
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March 12, 2014
Chairman Robert Goodlatte
Committee on the Judiciary
United States House of Representative
Washington, DC 20005

Dear Chairman Goodlatte,

The International Council of Shopping Centers (ICSC) is seeking urgent passage of legislation to provide a federal solution for the sales and use tax inequity that community based retailers have faced for decades.

Founded in 1957, ICSC is the premier global trade association of the shopping center industry. Its more than 60,000 members in over 100 countries include shopping center owners, developers, managers, marketing specialists, investors, retailers and brokers, as well as academics and public officials. As the global industry trade association, ICSC links with more than 25 national and regional shopping center councils throughout the world.

ICSC appreciates the committee holding today's hearing "Exploring Alternative Solutions on the Internet Sales Tax Issue" and hopes that the discussion will provide clarity and direction for the committee to move forward rapidly with legislation to give states the authority to modernize their sales and use tax laws and bring them into accordance with today's multichannel marketplace.

For more than 20 years, ICSC has been actively involved in trying to find a pathway forward from the 1992 Supreme Court *Quill* decision. In the meantime, the retail environment and technological capabilities have provided many of their own solutions to the issues of complexity that have held back e-fairness for merchants for so many years.

While we have been strong supporters of the Marketplace Fairness Act passed with strong bipartisan support by the Senate in May 2013, we consider other workable solutions to this problem to be possible and worth considering.

ICSC has significant concerns about some of the concepts that are being discussed. Most notably, we believe that origin sourcing is a fundamentally flawed concept that could create unintended consequences and undermine the purpose of passing legislation by creating tax havens for remote sellers and placing a new tax on consumers, forcing purchasers to pay sales and use taxes to a state that they do not live or vote in.

Again, thank you for the thought and attention the committee has focused on this important issue. The time has truly come to do the right thing and provide sales and use tax parity across all channels of sale. It is time to treat a sale as a sale no matter where it takes place.

Sincerely,

Betsy Laird

Betsy Laird
Senior Vice President, Global Public Policy
International Council of Shopping Centers

Streamlined Sales Tax Governing Board, Inc.

March 12, 2014

The Honorable Bob Goodlatte
Chairman
House Judiciary Committee
2309 Rayburn House Office Building
Washington, DC 20515

The Honorable John Conyers, Jr.
Ranking Member
House Judiciary Committee
2426 Rayburn Building
Washington, DC 20515

Dear Chairman Goodlatte and Ranking Member Conyers,

Thank you for holding today's hearing on possible solutions to the remote sales tax collection issue and working on advancing this important legislation this year. Although we understand that you want to consider various alternatives to what the Streamlined Sales Tax Governing Board (SSTGB) has already developed, we believe that a complete analysis of the remote sales tax collection issue should include an examination of the Streamlined Sales and Use Tax Agreement (SSUTA). Signed in 2002, the SSUTA is the collaborative effort between the states, local governments, the business community and other stakeholders to voluntarily streamline state and local sales and use tax systems. Therefore, we are identifying the components critical to overall simplification of sales tax collection and administration which the SSTGB, working with our stakeholders, has developed over the last 10+ years. We believe these components should be considered in any federal solution.

The goal of the SSTGB is to make the collection of sales and use taxes in states where a seller does not have a physical presence as simple and burden-free as possible. The success of the "Streamlined" effort has been the result of considering numerous alternatives and then vetting those alternatives amongst legislators, tax administrators, local government officials, tax accountants, attorneys and members of the business community who had a great deal of experience and understood the pros and cons of the alternatives being considered. These stakeholders developed the best solutions through deliberation and compromise. The effort has resulted in a system of simplification and uniformity that over 2,100 sellers have voluntarily registered and agreed to collect the appropriate sales and use taxes in all 24 of our member states – regardless of physical presence in the state.

As you prepare for the upcoming hearing "Exploring Alternative Solutions to the Internet Sales Tax Issue," we want to explain some of the key components of the SSUTA that the SSTGB believes are critical in crafting the federal solution, and in some cases, have already been adopted by 24 states. They are:

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- *Central Registration System* – A central registration system for all of the states that receive collection authority under the federal solution should be put in place to make it very simple and easy for sellers to register to collect and remit the taxes. The SSTGB has accomplished this through our central registration system, which we are in the process of upgrading and have solicited input from non-SSTGB states and welcome their continued input and participation.

- *Certified Automated Systems* – Certified Automated Systems that handle the seller's tax calculation and reporting are available and provided at no charge to the sellers for those states where sellers do not otherwise have a legal requirement to collect the tax.

  The persons providing these automated systems are required to include the software and services necessary to setup and integrate the software with the seller's system. The SSTGB currently contracts for the necessary software and services through our six certified service providers. Since there are all different sizes and types of businesses that use this software, it is important to offer many different options and to certify as many different providers as possible.

- *Uniform Certification Procedures Related to the Certified Automated Systems* – Uniform procedures are in place to certify the automated systems. Certifying the systems means that the states have initially reviewed the systems to make sure they can accomplish the following tasks at the time of the sale:
  - Determine the location of a sale – based on address/zip code;
  - Determine the appropriate state and/or local sales tax rates that apply in the jurisdiction to which the transaction was sourced; and
  - Determine whether the transaction is taxable or exempt.

  The systems also:
  - Compile the data necessary to prepare the appropriate sales and use tax returns for each of the states;
  - File the necessary returns; and
  - Make the appropriate tax remittances.

  Once an automated system is reviewed and certified by the states, there is ongoing testing to make sure the automated system is kept up-to-date and continues to function properly. The SSTGB accomplishes this by having states provide test decks (i.e., numerous test transactions) that the service providers run through their systems and the states make sure the proper results are returned.

- *Liability Relief* – The reason for certifying these systems is so that the states can indicate they have reviewed the system and to ensure that the systems are making the proper tax determinations at the time of the sale. If an error is made and the seller/provider did what the

Streamlined Sales Tax Governing Board, Inc.

states told them to do through the certification process, the states provide liability relief to the seller and service provider with respect to these errors.

- *Other Components* – In addition to the points above, the SSUTA also addresses the following:
  - *Taxability matrix* – Information on what is taxable and what is exempt is provided in a standardized, downloadable format so that sellers know what is and what is not taxable in a state. The SSTGB accomplishes this through our taxability matrix.
  - *Rate and jurisdiction databases* – These databases are required to be provided in a standardized, downloadable format.
  - *Single return within a state* –The state is required to administer the state and local taxes that are required to be collected within that state under this federal authority. Instead of sellers having to file numerous sales and use tax returns within a single state, these sellers are only required to file a single return within a state.
  - *Uniform tax base* – A uniform tax base for state and local tax purposes is required.
  - *Uniform sourcing rules* – Uniform sourcing rules are required so that a transaction is only sourced to a single location.

Although there are numerous other requirements that states must follow in order to join the SSTGB, we believe that any federal solution should consider, at a minimum, the above-identified components. We would welcome further dialogue on the information provided above and are available at any time to provide additional details and answer any questions you may have.

Thank you again for holding this hearing and moving this important policy issue forward in your Committee. The SSTGB looks forward to working with you to find the most effective solution to address remote sales tax collection for state and local governments, businesses and consumers alike.

Sincerely,

Diane L. Hardt

Diane L. Hardt, President
Streamlined Sales Tax Governing Board, Inc.

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NATIONAL ASSOCIATION OF ELECTRICAL DISTRIBUTORS

TESTIMONY TO THE UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON THE JUDICIARY

Exploring Alternative Solutions on the Internet Sales Tax Issue

Submitted by:
Edward M. Orlet, Vice President for Government Affairs
National Association of Electrical Distributors
1181 Corporate Lake Drive
St. Louis, Missouri 63132

March 12, 2014

Chairman Goodlatte, Ranking Member Conyers, esteemed Members of the Committee, the National Association of Electrical Distributers (NAED) appreciates this opportunity to present this written testimony to the House Judiciary Committee concerning the Marketplace Fairness Act (MFA), and describe how online retailers' ability to dodge sales taxes unfairly harms traditional businesses.

NAED is one of America's oldest professional associations. Founded in 1908 as the Electric Supply Jobbers Association, NAED has evolved over time to become the pre-eminent voice for the $90 billion electrical wholesaling industry. In 1969, we created the NAED Research and Education Foundation to provide the highest quality training and information to our members. NAED is proud to represent more than 400 member companies with more than 5,000 locations nationwide, employing more than 180,000 people including salespeople, product experts, skilled and technical professionals, warehouse associates, and drivers that bring the latest technology to our communities. NAED is a 501 (C)(6) .

In the fall of 2013, you released seven "basic principles pertaining to the issue of Internet sales tax ... to guide discussion on this issue and spark creative solutions." We applaud your leadership in providing "a starting point for discussion in the House of Representatives," and urge you to now move this discussion forward with the development and advancement of legislation based on these basic principles.

As you know, it has been more than two decades since the United States Supreme Court's ruling in Quill v. North Dakota effectively exempted remote sellers from the sales tax collection obligation states impose on their local brick and mortar competitors. The Court's opinion did acknowledge Congress' authority in this matter: "(T)he 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 ... Accordingly, Congress is now free to decide whether, when, and to what extend the States may burden interstate mail order concerns with a duty to collect use taxes."

NATIONAL ASSOCIATION OF ELECTRICAL DISTRIBUTORS

Nearly 22 years later, the dynamics of the marketplace have substantially changed with the advent of the internet and growth of e-commerce. And these dynamics, which initially manifested themselves in the retail sector, have more recently arrived on the scene in the business-to-business (B2B) sales space in which wholesaler-distributors "live". According to the 2013 study of trends in wholesale distribution conducted by the National Association of Wholesaler-Distributors Institute for Distribution Excellence ("NAW Institute") and IBM titled Facing the Forces of Change: Reimagining Distribution in a Connected World®, in the same way that the shift toward e-commerce is "rapidly transforming the retail landscape ... e-commerce will now continue to transform wholesale distribution ... by 2017, a full 92% of distributors surveyed will offer e-commerce ... On average, online orders make up 9% of distributor revenues today, but that proportion is expected to surge to 21% by 2017, an increase of 130%." Fourth quarter 2013 survey data reported in Modern Distribution Management (MDM) earlier this year reveals that 21% of respondents see on-line only players as a larger competitive threat than their "traditional" competitors. Our expectation that e-commerce will continue to grow in the B2B space is reflected in MDM's survey finding that 70% of their survey's distributor respondents will invest in e-commerce this year, and is further underscored by the NAW Institute/IBM study finding reported in Facing the Forces® that 78% of distributors plan to invest in this area through 2017. Consequently, our wholesaler-distributor memberships are increasingly concerned about the clear advantage enjoyed by on-line remote sellers at the competitive expense of local brick and mortar sellers and convinced of the need for Federal legislation to address this inequity.

Last Spring, the Senate passed the Marketplace Fairness Act with our support. This legislation empowers the states to fully enforce their sales and use tax laws by requiring remote sellers to collect and remit sales and use taxes that are already owed by purchasers, just as local brick and mortar businesses must do. We urge the Judiciary Committee, under your leadership, to quickly develop internet sales tax legislation based on your basic principles to empower the states to treat all sellers equally as to their obligation to collect and remit state sales and use taxes. We look forward to working with you as the legislative process unfolds on this important matter.

We respectfully request that this letter be added to the official hearing record.

Sincerely,

Edward M. Orlet
National Association of Electrical Distributors

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March 11, 2014

The Honorable Bob Goodlatte
Chairman, House Judiciary Committee
2309 Rayburn House Office Building
Washington, DC 20515

The Honorable John Conyers, Jr.
Ranking Member, House Judiciary Committee
2426 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Goodlatte and Ranking Member Conyers,

On behalf of the 1 million members of the National Association of REALTORS® (NAR) and its affiliates, the CCIM Institute, the Institute of Real Estate Management (IREM), the Society of Industrial and Office REALTORS® (SIOR), and the REALTORS® Land Institute (RLI), thank you for holding tomorrow's hearing entitled "Exploring Alternative Solutions to the Internet Sales Tax Issue." NAR supports equitable sales tax treatment of all sellers, which is why we support S.743, the "Marketplace Fairness Act of 2013," introduced by Senators Enzi (R-WY), Alexander (R-TN), Heitkamp (D-ND), and Durbin (D-IL), and its companion bill in the House, H.R. 684, introduced by Representatives Womack (R-AR) and Speier (D-CA). S.743 was passed by the Senate and has since been referred to the House Judiciary Committee.

While consumers are required under most state laws to pay sales and use taxes on their purchases, online sellers are not currently required to collect the tax in the same way that local businesses do. This unequal treatment puts local "brick-and-mortar" businesses at a competitive disadvantage. The resulting pressure on established retail districts and historic downtowns can adversely affect overall economic sustainability in a community, and can also lead local jurisdictions to attempt to make up the lost revenue by increasing property taxes which are paid by local businesses and residents.

Internet and other remote sellers, however, are typically physically located far from their customers, and do not pay property and other local taxes to help support local infrastructure of the communities in which they do business. Brick-and-mortar retailers do pay these taxes, and are thus put at a competitive disadvantage.

The Marketplace Fairness Act, a bipartisan piece of legislation, would authorize state governments to require remote sellers to collect sales taxes on Internet sales of goods that are delivered to their states. This measure would level the playing field between brick-and-mortar and e-commerce retail businesses, while assisting the states in collecting approximately $23 billion in uncollected state sales and use taxes that are currently due on Internet and remote sellers.

NAR thanks the Committee members for their attention to this issue. We look forward to working with Congress to resolve this inequality in the sales tax treatment of traditional brick-and-mortar businesses and e-commerce retailers.

Sincerely,

Steve Brown
2014 President, National Association of REALTORS®

cc: House Judiciary Committee Members

The Honorable Robert Goodlatte
Chairman
House Judiciary Committee
2138 Rayburn House Office Building
Washington, DC 20515

The Honorable John Conyers
Ranking Member
House Judiciary Committee
2138 Rayburn House Office Building
Washington, DC 20515

Cc:The Honorable Jim Sensenbrenner
The Honorable Howard Coble
The Honorable Lamar Smith
The Honorable Steve Chabot
The Honorable Spencer Bachus
The Honorable Darrell Issa
The Honorable Randy Forbes
The Honorable Steve King
The Honorable Trent Franks
The Honorable Louie Gohmert
The Honorable Jim Jordan
The Honorable Ted Poe
The Honorable Jason Chaffetz
The Honorable Tom Marino
The Honorable Trey Gowdy
The Honorable Raul Labrador
The Honorable Blake Farenthold
The Honorable George Holding
The Honorable Doug Collins
The Honorable Ron DeSantis
The Honorable Jason Smith

The Honorable Jerry Nadler
The Honorable Bobby Scott
The Honorable Zoe Lofgren
The Honorable Sheila Jackson Lee
The Honorable Steve Cohen
The Honorable Hank Johnson
The Honorable Pedro Pierluisi
The Honorable Judy Chu
The Honorable Ted Deutch
The Honorable Luis Gutierrez
The Honorable Karen Bass
The Honorable Cedric Richmond
The Honorable Suzan DelBene
The Honorable Joe Garcia
The Honorable Hakeem Jeffries
The Honorable David Cicilline

Dear Chairman Goodlatte, Ranking Member Conyers, and distinguished Judiciary Committee members:

As the members of this Committee well know, requiring out-of-state retailers to collect sales taxes for products sold over the Internet, in catalogs, and through radio and TV ads and sent to the state where a shopper lives, is an issue of great interest and contention. States and localities certainly have a rightful claim to collect revenue that is generated in their state; however, a major question before your committee is whether is it lawful to force businesses to collect sales tax for other states, counties and cities. The Marketplace Fairness Act (H.R. 684) that currently resides in your committee's jurisdiction seems to be the legislation that will deliver the mechanisms to collect sales and use taxes generated through E-Commerce and other remote sales.

There have been many voices heard on whether H.R. 684 should be enacted into law as written. The Agricultural Retailers Association (ARA) and the National Council of Farmer Cooperatives (NCFC) would like to bring to your attention an issue within the underlying bill that potentially could be a big problem for many industries if not favorably resolved. Agricultural retailers play a vital role in the agricultural community. Our members supply farmers and ranchers with

essential crop inputs such as seed, feed, fertilizer, crop protection products and the agronomic counsel to accompany those products. Given the nature of their day to day transactions, our members encounter a great deal of tax exemptions due to the products we sell and to whom we are selling these products. One of the most common "product-use" exemptions applies to products used in agricultural production (farming). Most states provide an exemption for products used in farming; however, state laws vary dramatically in the extent to which the exemption applies to the myriad of products, equipment, supplies, fuels, repair parts and other items used in farming and typically found on our shelves. Furthermore, published guidance on eligibility for the farm exemption (to specific products) is often difficult for even the most diligent of farm suppliers to find.

As you are aware, H.R. 684 provides two paths for sales and use tax collection. Those states that are streamlined will function within that capacity and un-streamlined states will adhere to minimum simplification requirements. In its current form, H.R. 684 does not provide simplification for "product use" exemptions. As a result, this legislation will dramatically increase the burden on remote sellers whose products are subject to "product-use" exemptions.

Currently, the Marketplace Fairness Act would require remote sellers of agricultural products to:

- Obtain a properly completed and signed sales tax exemption certificate from each purchaser claiming the farming exemption from sales tax. Such certificates must be retained and produced years later for sales tax audits.
- Many states require agricultural exemption certificates that are unique to their state (There is very little uniformity among states with agricultural exemptions).
- A number of states require farmers to register with the state, as frequently as annually, to obtain a numbered permit allowing them to claim the agricultural exemption. The seller must then obtain a copy of the permit (and renewals) to defend against sales tax audits which may occur years later.
- In addition to the burdens arising from obtaining and retaining proper exemption certificates, remote sellers of agricultural products would also be required to perform detailed analyses of each state's laws to determine which products would or would not qualify for the farming exemption in each state. Remote sellers would also have to constantly monitor each state for exemption changes resulting from new laws, regulations, court cases, and/or rulings issues by each state's tax authorities.

Additionally, the notion that free software is the solution to fix all of the issues within this legislation is troubling to agricultural retailers. Agricultural retailers, like many other businesses, have deeply personalized software programs they have used over many years to accommodate their individual business needs. Many hours of high-waged labor would be required to implement and care for this "free" software that would in no-way address our concerns regarding product-use exemptions. Simply put, this software would not be the easy fix for the agricultural retail industry and it seems that others who have to deal with product use exemptions would feel the same.

In summary, H.R. 684 would place heavy burdens on agricultural retailers if enacted "as is." Agribusinesses will have to study the laws of all states that impose sales tax, determine

application of those laws to the seller's product line, and obtain and retain exemption certificates. All of these additional efforts and expenses will be necessary solely for the purpose of defending agribusinesses from state tax audits, where the majority of such sales would have been eligible for an exemption in the first place. If this existing language becomes law, the transaction reporting requirements and matrix updating responsibilities of these product use tax exemptions would fall upon the retailers. The costs associated with these obligations would be a major deterrent for agricultural retailers currently involved in E-Commeree and it will also likely prevent other agribusinesses from expanding into an online model in the future. This law should provide for appropriate and lawful tax collection within the existing framework, not become a barrier to interstate commerce. While our members appreciate the concerns of the States and "Main Street," ARA and NCFC cannot support the Marketplace Fairness Act as written. However, as the process moves forwards, we hope to work with the members of this Committee and others within the sales and use community to find a workable solution.

Thank you for your consideration of our views. Should you have any comments or concerns, please contact Jeff Sands, Director of Public Policy for the Agricultural Retailers Association at jeff@aradc.org or 202-595-1705.

Sincerely,

Agricultural Retailers Association
National Council of Farmer Cooperatives

amazon.com.

March 10, 2014

The Honorable Bob Goodlatte
Chairman, Committee on the Judiciary
U.S. House of Representatives
2138 Rayburn House Office Building
Washington, DC 20515

The Honorable John Conyers
Ranking Member, Committee on the Judiciary
U.S. House of Representatives
B-351 Rayburn House Office Building
Washington, DC 20515

Re: Hearing on Exploring Alternative Solutions on the Internet Sales Tax Issue

Dear Chairman Goodlatte and Ranking Member Conyers:

Thank you for calling a hearing to discuss the collection of state tax on interstate sales. Amazon is grateful for your attention to this important issue, and we look forward to enactment of a federal law authorizing states to require all but the smallest-volume interstate sellers to collect.

The policy reasons for enacting such legislation are well known: states' rights to make revenue policy choices; fairness among sellers; federal help for state budgets without federal spending, etc. More fundamentally, this legislation is sorely needed to remove the constraints on commerce imposed by a 1992 Supreme Court decision. In that decision, the Court upheld a 1967 ruling in which the Court had substituted for Congress the Court's evaluation of sales tax on interstate commerce. The 1992 Court then invited Congress to assert its superior constitutional authority under the Commerce Clause. Amazon believes that Congress should accept the Court's invitation and act now to supplant the Court's woefully outdated surrogate judgment, which is inconsistent with the realities of modern commerce.

Amazon strongly supports enactment of the Marketplace Fairness Act (MFA), which is before your Committee as H.R. 684, and was passed by the Senate last spring as S. 743. Compared to similar bills introduced over the preceding decade, the MFA's great advantage is that it does not require states to adopt all the tax law simplifications of the multistate Streamlined Sales and Use Tax Agreement (SSUTA). Rather, it provides states an alternative to make only a limited set of simplifications. This advantage is a tacit acknowledgement that automation has eased the ability of sellers to comply with sales tax laws since the SSUTA was adopted a decade ago, and it also facilitates inclusion of non-SSUTA states, generally the more populous ones.

We acknowledge, of course, that despite the MFA's virtues, it probably is not perfect. Indeed, the MFA could be tweaked or, for that matter, rewritten entirely, and the five alternatives that will be discussed at your Committee's upcoming hearing represent several ways the MFA could be modified.

Nonetheless, we believe it is important for the Committee to recognize that such modifications are unnecessary for one key reason: today's technology and services that automate sales tax calculation, collection, and remittance make compliance with the MFA as easy and cheap as compliance with a modified or alternative MFA, whether or not additional simplification of state tax laws is required.

For context, recall that in its 1992 decision, the Court opined that requiring compliance with the complexity of state sales tax laws would impose an unconstitutional burden on interstate commerce. Subsequently, roughly half the states (generally the less populous ones) tried for years to abate that complexity the only way possible at the time: by simplifying their tax laws, culminating in the SSUTA.

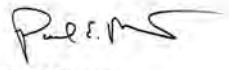
Now, however, dramatic simplification of tax law is no longer necessary because current automation technology and services can handle the existing complexity of various tax rates, local jurisdictional boundaries, etc. This is particularly true of cloud-based computing services, *e.g.*, Avalara's "AvaTax," which entail little or no start-up cost and charge sellers only for the tax calculation, collection, and remittance services they actually use, at pennies per transaction. In other words, today's automation already – *without any tax law simplification at all* – makes compliance uncomplicated and inexpensive for all but the very smallest-volume interstate sellers. Thus, there is little need for Congress to require simplification of current state law, and absolutely no need for Congress to require simplification beyond the strictures of the current MFA bill which, although likely imperfect, certainly is more than sufficient.

Yet, although today's sophisticated automation can eliminate legal *complexity*, it cannot resolve legal *uncertainty* – especially the uncertainty about where particular interstate sellers must collect sales tax. This uncertainty has increased dramatically over the past five years as the states have grown impatient and have attempted to take interstate tax collection matters into their own hands, constitutionally or not. No matter how capable automation may be, it is impossible to write software to resolve the increasing uncertainty about where sellers must collect. To make matters worse, in December 2013 the Supreme Court rejected a petition to reestablish some semblance of nationwide certainty on this question. After two decades, the Court is allowing its 1992 "bright line test" to blur, to the detriment of interstate commerce.

With the Supreme Court apparently uninterested in yet again substituting its evaluation for Congress's constitutional authority, only Congress can address the growing legal uncertainty about where sellers have a responsibility to collect tax on interstate sales. Therefore, Congress should enact a law authorizing states to require all but the smallest-volume sellers to collect, and the MFA before your Committee would suffice, with or without modification.

Thank you again for calling a hearing to address this important issue. Please let me know if Amazon may assist the Committee in any way.

Sincerely yours,



Paul Misener
Vice President for Global Public Policy

cc Members of the Committee on the Judiciary

Plano
City of Excellence

City of Plano
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Tel: 972.941.7000
plano.gov

February 28, 2014

House Judiciary Committee
United States House of Representatives
2138 Rayburn House Office Bldg.
Washington, DC 20515

Dear Chairman Goodlatte:

The City of Plano supports passing the Marketplace Fairness Act (MFA) which is scheduled to be heard by the House Judiciary Committee on March 4th, 2014, and requests your support in passing this important piece of legislation. I strongly believe that this legislation will level the playing field for "main-street" Plano by assuring that all companies doing business in Plano play by the same rules.

Plano has strong reputation for being pro-business as evidenced by the 6 fortune 1,000 headquarters that choose to call Plano home. Plano has 14 corporations with more than 1,000 employees and more than 147,000 people come to Plano to work each day.

Our belief is any company who does business in Texas should abide by the laws and regulations established in our state. If businesses who reside in another state aren't held to the same standard, it could negatively affect our local businesses.

We strongly urge you to support the proposed Marketplace Fairness Act, and thank you for your support.

Sincerely,

Harry LaRosiliere
Mayor

CC: Representative Sam Johnson
Representative Kenny Marchant

NATIONAL
ASSOCIATION
OF
REAL ESTATE
INVESTMENT
TRUSTS®

REITs:
BUILDING
DIVIDENDS
AND
DIVERSIFICATION®

March 11, 2014

The Honorable Robert W. Goodlatte
Chairman, Committee on the Judiciary
United States House of Representatives
Washington, D.C. 20515

Dear Chairman Goodlatte:

The National Association of Real Estate Investment Trusts® (NAREIT®)[1] commends the House Judiciary Committee for holding its March 12 hearing regarding "Exploring Alternative Solutions on the Internet Sales Tax Issue." We are hopeful that the information developed at the hearing will expedite the Committee's consideration of the internet sales and use tax issue, and help move the matter to a satisfactory resolution.

NAREIT not only supports the Marketplace Fairness Act that passed the Senate with strong bipartisan support last May, but we are also in favor of any other reasonable and workable solution which may be developed by your Committee.

Simply put, NAREIT urges enactment this year of legislation providing a bipartisan solution to the unsustainable and inequitable differing sales tax and use tax collection requirements that currently exist between "remote" and "brick-and-mortar" retailers. Such a step would provide a level playing field for off-site, out-of-state and on-site, in-state sellers, and would assist states in collecting billions of dollars of currently owed but unpaid sales and use taxes.

Absent Congressional action, the current sales price discrimination against Main Street retailers stemming from the tilted playing field in effect today will be only magnified as remote sales continue to increase relative to on-site sales. Plainly stated, remote vendors should not be afforded by Congress with an economic advantage over brick and mortar businesses that are the lifeblood of our communities.

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[1] NAREIT is the worldwide representative voice for real estate investment trusts (REITs) and publicly traded real estate companies with an interest in U.S. real estate and capital markets. NAREIT's members are REITs and other businesses throughout the world that own, operate, and finance income-producing real estate, as well as those firms and individuals who advise, study, and service those businesses. NAREIT's members include the lessors of shopping centers, regional malls and free standing retail properties whose tenants are legally obligated under current law to collect the sales tax applicable to in-state purchases, while many online and other remote retailers are not so obligated.

1875 I Street, NW, Suite 600, Washington, DC 20006-5413
Phone 202-739-9400 Fax 202-739-9401 REIT.com

Thank you for your leadership on this issue and for your efforts to achieve a workable solution for all interested parties. NAREIT believes now is the time for Congress to approve parity between remote and on-location sellers with respect to sales and use tax collection responsibilities.

Respectfully submitted,

Steven A. Wechsler
President and CEO

National Retail Federation®
The Voice of Retail Worldwide

March 12, 2014

The Honorable Bob Goodlatte
Chairman
House Judiciary Committee
U.S. House of Representatives
Washington, D.C. 20515

The Honorable John Conyers
Ranking Member
House Judiciary Committee
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Goodlatte and Ranking Member Conyers:

Thank you for holding this hearing examining solutions to the Internet sales tax collection issue. The National Retail Federation (NRF) is the world's largest retail trade association, representing discount and department stores, home goods and specialty stores, Main Street merchants, grocers, wholesalers, chain restaurants and Internet retailers from the United States and more than 45 countries. Retail is the nation's largest private sector employer, supporting 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 This is Retail campaign highlights the industry's opportunities for life-long careers, how retailers strengthen communities, and the critical role that retail plays in driving innovation. www.nrf.com

Members of the National Retail Federation believe that Congress must resolve the Constitutional questions posed by the *Quill* decision in a fashion which promotes a level playing field between retail competitors. As retailing evolves and Internet sales become a more prominent portion of total retail sales[1], it is critical that Congress address the sales tax collection discrimination that exists between brick-and-mortar and remote retailers.

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 compelled by the government to collect sales taxes. This situation is not created by the marketplace, but rather it is a disadvantage imposed by the current state of the law following the *Quill* decision, stifling retailers across the country.

If Congress permits the state to only collect the sales tax on sales that occur in stores in that state and not all sales made online into that state, then Congress is creating an unlevel playing field to the disadvantage of local stores in congressional districts. Given the rise in online sales, continuation of this system will create such an unfair burden on those consumers that actually pay taxes due and states will have to move away from sales tax systems and find other sources of revenue (e.g. more reliance on income taxes).

[1] According to the U.S. Census Bureau, online sales accounted for approximately 6.0 percent of total retail sales in the fourth quarter of 2013. http://www.census.gov/retail/mrts/www/data/pdf/ec_current.pdf.

Consumption taxes are imposed on the sale or use of goods and some services that are subject to the tax. A sales tax is a tax on the consumer and is imposed where the consumption takes place. So all sales in a given state are subject to the sales tax, regardless of whether the sale occurs in a store in the state or in the home of a resident of the state through their computer or telephone. If Congress permits the state to only collect the sales tax on sales that occur in stores in that state and not sales on a computer in that state, then Congress would be discouraging intra-state commerce because retailers that sell goods within the state are at a competitive disadvantage vis-à-vis remote sellers. Some proposals have encouraged changing the sales and use taxes enacted by states from consumption taxes on consumers to production taxes on retailers through an origin based sourcing system. NRF is opposed to such a scheme and the necessary implications of such a scheme creates a new tax.

In addition to the perceived 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 high, placing them at more of a competitive disadvantage.[2] We are encouraged that the Committee's principles include recognition of the cost of compliance and hope that the Committee also reviews the impact of current compliance costs on retailers of all types and sizes.

Litigation risks abound for retailers in this area, particularly for retailers with a significant remote sales operation. In the void of Congressional action, states have taken it upon themselves to act in the area with a myriad of proposals. These state actions range from expanding the definition of nexus[3] (i.e. physical presence in a state) to reporting requirements for retailers to turn over customer purchase data to state tax departments.[4] NRF believes it is imperative for Congress to address this uncertainty in the marketplace by setting the rules of the road that place retailers on a level playing field for the future. Congress can ensure that both small brick-and-mortar retailers and small online sellers have a clear and competitive path forward without the government exacerbating a preference for one retail business model over another.[5]

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. The Supreme Court in *Quill* produced a road map for Congressional action in this area that will address many concerns raised by some opponents of sales tax fairness legislation. 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.

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[2] 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] *See Overstock.com, Inc. v. New York State Department of Taxation and Finance*, No. 13-252 (2013) (petition denied December 2, 2013). *See also* http://www.forbes.com/sites/janetnovack/2013/12/02/happy-cyber-monday-supreme-court-wont-hear-amazon-sales-tax-appeal/.
[4] *Direct Marketing Association v. Brohl*, No. 12-1175 (10th Cir. 2013).
[5] *See* Bruce, Donald and William Fox "An Analysis of Internet Sales Taxation and the Small Seller Exemption" Small Business Research Summary No. 416, SBA Office of Advocacy, November 2013 (discussion of small business impact of proposed legislation including share of online retailers collecting sales tax in multiple states).

Since late 1999, and the Supreme Court's decision in *Quill*, 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 have been passed by twenty-four states[6], establishing the necessary groundwork for action by Congress. The progress of this group should be taken seriously by the Committee in their examination of solutions to the remote sales tax collection issue.

NRF strongly believes that action by Congress to address the current discrimination against brick-and-mortar retailers should not impose any new taxes on the use of the Internet or any other channel of distribution. All retailers, regardless of the channel of sale, should be treated equally with respect to collection obligations required by state and local tax jurisdictions. The sales tax collection process should not significantly impact the customer's experience purchasing from remote sellers, and the collection of sales and use taxes under federal legislative authority does not create nexus with states for other purposes.

NRF is encouraged by this Committee's interest in address the Internet sales tax issue as well as the recent bipartisan passage of the Marketplace Fairness Act, S. 743, by the U.S. Senate on May 6, 2013.[7] NRF has long supported Congress granting states remote collection authority with required simplifications to ensure all retailers are not unduly burdened by collecting and remitting sales taxes. 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.

Sincerely,

David French
Senior Vice President
Government Relations
National Retail Federation

[6] FAQ "How many states have passed legislation conforming to the Agreement?" Streamline Sales Tax and Governing Board, Inc. http://www.streamlinedsalestax.org/index.php?page=gen_3 (last accessed March 2014).
[7] Senate Record Vote #113, 113th Congress (2013-2014). Agreed to 69 to 27.

Mr. GOODLATTE. We welcome our distinguished panel today, and if you would all rise, we will begin, as is the custom of this Committee, by swearing you in.

[Witnesses sworn.]

Mr. GOODLATTE. Let the record reflect that all of the witnesses responded in the affirmative. Thank you. And I will begin by introducing Mr. Stephen Kranz, a partner at McDermott Will & Emery in Washington, D.C. He engages in all forms of taxpayer advocacy, including audit, defense, and litigation, legislative monitoring, and formation and leadership of taxpayer coalitions.

Steve is at the forefront of State and local issues, including developments arising in the world of cloud computing and digital goods and services. Mr. Kranz was recognized by State Tax Notes as one of the top 10 tax lawyers and as one of the top 10 individuals who influenced tax policy and practice for 2011.

Mr. Kranz received his B.A. magna cum laude from the University of North Dakota and his J.D. with honors from Drake University Law School.

Mr. Will Moschella is a shareholder at Brownstein Hyatt Farber & Schreck. He previously served as principal associate deputy attorney general for the Department of Justice, advising the deputy attorney general on a range of law enforcement, national security, and general administrative matters. In 2003, the Senate confirmed him as assistant attorney general for the Office of Legislative Affairs.

Mr. Moschella has also served in a number of high-profile Capitol Hill positions, including chief counsel to the House Judiciary Committee and general counsel to the House Committee on Rules. Mr. Moschella received his B.A. from the University of Virginia and his J.D. from George Mason University School of Law.

Mr. JAMES H. Sutton, Jr. is a shareholder at Moffa, Gainor & Sutton. He concentrates on Florida tax matters with an almost exclusive focus on Florida's sales and use tax. He has been a licensed certified public accountant since 1994 and a licensed member of the Florida Bar since 1998. Mr. Sutton has 8 years of experience handling a wide variety of State tax planning and consulting work for Fortune 1000 companies.

Mr. Sutton is an adjunct professor of law at Boston University and Stetson University College of Law, where he teaches State and local tax, accounting for lawyers, and sales and use tax law.

Mr. Sutton is a graduate of Stetson University, received a master's from Mississippi State University, his J.D. from Stetson University College of Law, and his master of laws in taxation from the University of Florida, Levin College of Law.

Mr. Joe Crosby is a principal at MultiState Associates Incorporated. Previously he spent 11 years as chief operating officer and senior director on policy with the Council on State Taxation, an association representing 600 of the Nation's largest companies on State and local business tax issues. He is a nationally recognized expert on State on local business tax policy.

Prior to his work with the Council on State Taxation, Mr. Crosby was national director of State Legislative Services for Ernst & Young. He is past president of the State Government Affairs Coun-

cil, the premiere national association for multistate government affairs executives.

He earned his B.A. from Loyola-Marymount University in Los Angeles, and completed graduated coursework in economic policy at American University here in Washington.

Andrew Moylan is outreach director and senior fellow for R Street where he heads coalition efforts, conducts policy analysis, and serves as the organization's lead voice on tax issues.

Prior to joining R Street, Mr. Moylan was vice president of government affairs for the National Taxpayers Union, a grassroots taxpayer advocacy organization. He previously served with the Center for Educational Freedom at the Cato Institute and completed internships in the U.S. Senate and the House of Representatives with members from his home State of Michigan. Mr. Moylan's writings have appears in such publications as the Wall Street Journal, the New York Times, and the Weekly Standard.

He holds a degree in political science from the University of Michigan.

Mr. Chris Cox appears today as counsel for NetChoice. He is also a partner at Bingham McCutchen, LLP, where he is focused on Federal and State governments, cross-border investment, homeland security, and multistate litigation.

During a 23-year Washington career, Mr. Cox was chairman of the U.S. Securities and Exchange Commission, Chairman of the House Committee on Homeland Security, the 5th ranking elected member in the House, and a 17-year Member of the House from California.

Mr. Cox received his B.A. from the University of Southern California. He is a graduate of Harvard Law School, where he was an editor of the Law Review. After graduating, he clerked for Judge Choy in the United States Court of Appeals for the 9th Circuit. Mr. Cox also holds an M.B.A. from Harvard Business School where he later taught corporate and individual income tax.

Welcome to all of you, and a special welcome to our former colleague, Congressman Cox.

I ask that each summarize his or her testimony in 5 minutes or less. To help you stay within that time, there is a timing light on your table. When the light switches from green to yellow, you will have 1 minute to conclude your testimony. When the light turns red, that is it. It is done. And it signals the witness' 5 minutes have expired.

We welcome all of you again, and we will begin now with Mr. Kranz.

TESTIMONY OF STEPHEN P. KRANZ, PARTNER, McDERMOTT WILL & EMERY, LLP

Mr. KRANZ. Good morning, Mr. Chairman, Mr. Conyers, and Members of the Committee. I am Steve Kranz, a partner with McDermott Will & Emery, the law firm that litigated *Quill v. North Dakota* in 1992. I have a personal 15-year history with this issue. I was general counsel of COST, participated in the Advisory Commission on Electronic Commerce, spent 15 years that I will never get back attending meetings of the Streamline Sales Tax Project, the Streamline Sales Tax Implementing States, and now

the Streamline Sales Tax Governing Board, where I still serve as an ex officio member on behalf of the business community. So I have a 15-year history, but this issue goes back much further, and a little bit of it is worth repeating today because I am concerned history is repeating itself.

In 1967, the U.S. Supreme Court decided National Bellas Hess, gave us the physical presence rule. The States immediately became concerned about what that meant for the stability of their sales tax. In 1973, the first legislation was introduced in Congress to overturn not *Quill*, but *National Bellas Hess*. After about 10 years of trying to get Congress to act, the States were tired of waiting for a Federal solution and created something called the National Bellas Hess Project. It sounds a little familiar, but it is different than the Streamline Sales Tax Project.

In the 80's, the National Bellas Hess Project worked to force remote sellers to collect tax and, in fact, was able to pressure many of them to do so until they ran into Quill. Quill litigated the case to the U.S. Supreme Court and reaffirmed the National Bellas Hess case. That history is being repeated today, and I am not going to talk about the Streamline Project and what they are doing in trying to create a path forward. I am going to talk about the 17 States that have passed legislation going a different route.

There are 17 States that have passed one of three types of legislation. My favorite is the legislation that we call "Quill is dead," simply articulating a new rule at the State level without Federal involvement that *Quill* is no longer good law. Now, the State has not sought to enforce that legislation, but it is easy to see a path forward for the States if Congress does not act to solve this problem where they simply begin assessing enforcing remote sellers to either collect tax or litigate in many states at the same time. That is not a good recipe for remote commerce or for the economy.

The 113th Congress has made unprecedented progress. We had a bill pass the Senate last year. This hearing, looking at alternatives and the principles that have been put forward by the Chairman, is unprecedented in the history of this issue, and we applaud the effort and the progress.

I would offer you three points. One, only Congress can create a Federal framework that ensures remote sales tax collection is governed by common sense rules that protect remote sellers, that give them technology, and the tools, and the protection that they need to do the job States are going to ask them to do. Second, without a Federal framework, it is clear that the States are moving to declare *Quill* no longer good law. And third, should you decide to adopt a Federal framework, do so by modifying our existing State and local sales tax structure, not by upending sales tax as we know it today and adopting a new form of taxation or a new data reporting regime.

Now, I will comment briefly on some of the alternatives that will be discussed today, in particular the origin sourcing and the reporting regime proposals.

On the origin regime proposals that you will hear, both of them would tax not based on a buyer's location, but based on where the seller is located, and I am not sure what "located" means. Both of them would result in tax being imposed on Virginia consumers

based on the location of the vendor. If the vendor was in D.C., D.C.'s tax would apply to that transaction.

Both of them would create exemptions for foreign sellers carving them out of the sales tax collection obligation absolutely unless they had physical presence in a jurisdiction, while requiring domestic sellers to deal with the tax burden. Both of them would harm State sovereignty by eliminating the option of States imposing taxes on consumption. Both of them are easily manipulated, making our State and local sales tax system essentially voluntary. No other country in the world uses this type of approach for obvious reasons. Origin is an alternative to remote sales tax collection in the same way that the VAT is an alternative. It is simply a different form of taxation.

On the reporting regime, obviously any regime mandated by Congress that would require retailers and States to capture consumer purchase information and report it raises concerns about big government, big data, and privacy. More importantly, though, I think for consumers, this is an effort that would simply shift all tax responsibility from business to purchasers. Purchasers would have the obligation to deal with compliance and audits. It is not a viable alternative in that it creates a whole new regime outside the tax system.

Now, in closing, Congress is the only one who can solve this problem. If it is not solved here, the States will do so.

[The prepared statement of Mr. Kranz follows:]

Testimony of Stephen P. Kranz
United States House of Representatives
Committee on the Judiciary
March 12, 2014

Testimony of

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Partner

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Before the

Committee on the Judiciary

Of the

United States House of Representatives

Hearing on

Exploring Alternative Solutions on the Internet Sales Tax Issue

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I. Introduction

Chairman Goodlatte, Ranking Member Conyers, members of the Committee on the Judiciary, I am Stephen Kranz, a Partner at the law firm of McDermott Will & Emery in the firm's Washington, D.C. office, and a member of its State and Local Tax Practice Group.[1]

I am honored by the Chairman's invitation to testify today. I have spent most of my professional career dealing with state and local tax issues and welcome the opportunity to share my views with the Committee.

Prior to entering private practice I served as the General Counsel to the Council On State Taxation (COST), a trade association that represents the interests of more than 600 of the nation's largest taxpayers on issues of state and local taxation. I started my career as a tax litigator for the U.S. Department of Justice. Since then I have focused entirely on state tax matters and in particular the issues surrounding taxation of sales made over the Internet.

With respect to the issue before the Committee today, my role at COST allowed me to participate in the Congressionally-organized Advisory Commission on Electronic Commerce and to represent the COST membership in the Streamlined Sales Tax Project and Implementing States. I helped found, and served as the President of, the Business Advisory Council to the Streamlined Sales Tax Governing Board, and I now sit as an *ex officio* member of the Governing Board itself. My role as an advocate for simplification, uniformity and a national framework to address this issue spans more than 15 years. Outside of this issue I help companies large and small understand, comply with, and, when warranted, contest state and local tax laws.[2]

II. Summary

Since *Quill v. North Dakota* was decided in 1992, remote sales have risen significantly both in absolute dollars and as a percentage of total sales. Although catalog sales have long been

[1] I note with great pride that Quill Corporation was represented in its suit against North Dakota before the U.S. Supreme Court by John E. (Jack) Gaggini, a partner at McDermott Will & Emery, who spent 37 years handling state tax litigation before he retired in December of 2013. *Quill Corporation v. North Dakota*, 540 U.S. 298 (1992).
[2] I note that my testimony today consists of my opinions and thoughts on this issue. None of my statements are made on behalf of my firm or any of my clients or clients of my firm.

part of the American retail system and have always raised sales tax issues,[3] the rise of the Internet has drastically changed the face of commerce. As members of this committee know, in *Quill*, the U.S. Supreme Court reaffirmed the rule that a state may not require remote sellers to collect sales tax[4] unless the remote sellers have physical presence in the state. As commerce continues to shift to the Internet, states have looked for ways to force remote sellers to collect tax, despite the Court's holding. Although one of the hallmarks of our federal system is to allow states to experiment with different ways to govern themselves and raise revenue, in this case the states have in some cases adopted wildly divergent, contradictory and burdensome laws that have harmed businesses and imposed an undue burden on interstate commerce. As the U.S. Supreme Court noted in *Quill*, Congress is expressly authorized to deal with this problem, and is better qualified to deal with this problem than the courts.

Congress has two choices regarding how it will react to the problems of collecting sales tax on remote sales: Congress can either (1) exercise its authority under the Commerce Clause to provide a framework under which states can enforce collection by remote sellers, or (2) Congress can do nothing. There is no question that states will continue to try forcing remote sellers to collect their sales taxes regardless of Congress' action or inaction. The question is whether Congress will provide the necessary framework to ensure that state collection efforts will be uniform, clear, predictable and fair or, in the alternative, Congress will remain silent and allow state collection efforts to be confusing, unpredictable, burdensome, and potentially discriminatory.

A radical departure from the existing sales tax regimes is not needed. Businesses, commerce, consumers and, perhaps most important, the United States economic system would be greatly enhanced if Congress were to fix the problem by exercising its Commerce Clause authority and provide a uniform structure for the state enforcement of sales tax collection on remote sales, a structure that will provide the simplifications, technology, and protections needed to eliminate any undue burden.

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[3] *Nelson v. Sears, Roebuck & Co.*, 312 U.S. 359 (1941); *Nelson v. Montgomery Ward & Co.*, 312 U.S. 373 (1941).
[4] I use the term "sales tax" to include both the sales tax and the complimentary use tax.

III. Congressional Inaction Has Resulted in Burdensome State Self-Help

In the past decade, individual states have adopted aggressive, dissimilar, and burdensome laws attempting to impose sales tax collection obligations on remote sellers. Although twenty-four states[5] have implemented simplification provisions under the Streamlined Sales and Use Tax Agreement, Congress has shown no inclination to reward those states for their efforts, and *Quill* still prevents the states from imposing sales tax collection obligations on remote sellers. If Congress does not overturn the *Quill* physical presence requirement and establish a framework for imposition of collection obligations on remote sellers, states will undoubtedly continue taking action that is constitutionally questionable, creates additional burdens on remote sellers, and invites litigation.

A. Historical Efforts to Simplify

The *Quill* physical presence requirement goes back at least as far as 1967, when the U.S. Supreme Court decided *Bellas Hess* and established the rule underlying the *Quill* decision.[6] In 1973 Congress introduced the first legislation seeking to eliminate the physical presence rule.[7] Since then no fewer than twenty-five bills have been introduced in Congress to address the issue.[8] None of these efforts have been successful. In the absence of a federal solution states

[5] The full member states are: Arkansas, Georgia, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, Nevada, New Jersey, North Carolina, North Dakota, Ohio, Oklahoma, Rhode Island, South Dakota, Utah, Vermont, Washington, West Virginia, Wisconsin, and Wyoming. Tennessee is an associate member. http://www.streamlinedsalestax.org/index.php?page=state-info (last visited Feb. 27, 2014).
[6] *National Bellas Hess, Inc. v. Department of Revenue of Illinois*, 386 U.S. 753 (1967).
[7] Interstate Sales and Use Tax Act, S. 282, 93d Cong. (1973).
[8] *See* Marketplace Fairness Act, S. 743, 113th Cong. (2013); Marketplace Fairness Act, S. 1832, 112th Cong. (2011); Marketplace Equity Act of 2011, H.R. 3179, 112th Cong. (2011); Main Street Fairness Act, S. 1452, 112th Cong. (2011); Main Street Fairness Act, H.R. 2701, 112th Cong. (2011); Main Street Fairness Act, H.R. 5660, 111th Cong. (2010); Sales Tax Fairness and Simplification Act, H.R. 3396, 110th Cong. (2007); Sales Tax Fairness and Simplification Act, S. 34, 110th Cong. (2007); Streamlined Sales Tax Simplification Act, S. 2153, 109th Cong. (2005); Sales Tax Fairness and Simplification Act, S. 2152, 109th Cong. (2005); Streamlined Sales and Use Tax Act, S. 1736, 108th Cong. (2003); Streamlined Sales and Use Tax Act, H.R. 3184, 108th Cong. (2003); Internet Tax Moratorium and Equity Act, S. 1542, 107th Cong. (2001); Internet Tax Moratorium and Equity Act, S. 2775, 106th Cong. (2000); Fair and Equitable Interstate Tax Compact Simplification Act of 2000, H.R. 4462, 106th Cong. (2000); Internet Tax Simplification Act of 2000, H.R. 4460, 106th Cong. (2000); Consumer and Main Street Protection Act of 1995, S. 545, 104th Cong. (1995); Tax Fairness for Main Street Business Act of 1994, S. 1825, 103d Cong. (1994); Equity in Interstate Competition Act of 1989, H. R. 2230, 101st Cong., 1st Sess. (1989); Equity in Interstate Competition Act of 1989, S. 480, 101st Cong., 1st Sess. (1989); Main Street Fair Competition Act of 1988, S. 2368, 100th Cong., 2d Sess. (1988); Equity in Interstate Competition Act of 1987, H. R. 3521, 100th Cong.,

have been working to solve the issue on their own. In 1999 Utah Governor Michael O. Leavitt asked the states to begin an effort to simplify their sales tax regimes to address the remote seller question. In March of 2000 the states held the first meeting of the Streamlined Sales Tax Project, an effort aimed at reducing the sales tax collection burden such that Congress would reward the states by giving them collection authority or that the states themselves could feel comfortable that their sub-national sales tax regime no longer imposed an undue burden on interstate commerce, therefore satisfying the *Quill* standard (even though the Supreme Court's *Quill* opinion states that such an imposition requires physical presence). Over the last 15 years, the Streamlined Sales Tax Project gave rise to the Streamlined Sales Tax Implementing States which gave rise to the Streamlined Sales and Use Tax Governing Board which oversees state implementation and participation in the Streamlined Sales and Use Tax Agreement ("SSUTA"). Each iteration of the effort has involved collaboration between states, local governments, main street retailers, and online retailers. While not all involved were supportive of the effort, the SSUTA attempted to develop a rational set of rules that, if applied to remote commerce, would reduce the burden of tax collection. Even today, additional states are considering legislation to become part of the SSUTA effort.[9]

In 2001, the first piece of legislation that would reward the SSUTA member states with an overturn of *Quill* was introduced in Congress.[10] In every session of Congress since then, similar legislation has been considered.[11]

1st Sess. (1987); Equity in Interstate Competition Act of 1987, S. 1099, 100th Cong., 1st Sess. (1987); H. R. 3549, 99th Cong., 1st Sess. (1985); Interstate Taxation Act of 1979, S. 983, 96th Cong., 1st Sess. (1979).

[9] *See, e.g.*, H.B. 857, 2014 Leg. (Fla. 2014); H.B. 2135, 27th Leg. (Haw. 2014). H.B. 1477. 1654 and 1721, 97th Gen. Assem., 2nd Reg. Sess. (Mo. 2014).

[10] *See* Internet Tax Moratorium and Equity Act, S. 1542, 107th Cong. (2001).

[11] *See, e.g.*, Marketplace Fairness Act, S. 743, 113th Cong. (2013); Marketplace Fairness Act, S. 1832, 112th Cong. (2011); Main Street Fairness Act, S. 1452, 112th Cong. (2011); Main Street Fairness Act, H.R. 2701, 112th Cong. (2011); Main Street Fairness Act, H.R. 5660, 111th Cong. (2010); Sales Tax Fairness and Simplification Act, H.R. 3396, 110th Cong. (2007); Sales Tax Fairness and Simplification Act, S. 34, 110th Cong. (2007); Streamlined Sales Tax Simplification Act, S. 2153, 109th Cong. (2005); Sales Tax Fairness and Simplification Act, S. 2152, 109th Cong. (2005); Streamlined Sales and Use Tax Act, S. 1736, 108th Cong. (2003); Streamlined Sales and Use Tax Act, H.R. 3184, 108th Cong. (2003).

The SSUTA itself seeks to reduce the burden of collection by requiring its participating states to adopt uniform definitions and administrative rules and by also providing commercial software that is certified for use in the tax collection process. SSUTA does not dictate what is taxable or the tax rates; it leaves those decisions to the sovereign states. The SSUTA has many other provisions too numerous to detail here, such as a centralized registration system, a uniform tax return, and a uniform rounding rule, all of which seek to reduce disparity among the states while respecting their sovereignty.

Although the SSUTA effort has improved tax collection practices and uniformity, it has not led to Congressional action. States, whether members of SSUTA or not, have responded to the lack of federal involvement by pursuing alternatives to SSUTA in an effort to expand their jurisdiction over remote sellers. The alternatives, while demonstrating creativity, push the edge of constitutional limits and cause increasing problems for all businesses.

B. Inconsistent and Unpredictable State-by-State Action to Address Collection Problem

In the last decade, states have enacted at least three types of legislation as self-help to address the lack of a federal solution.[12] The three types of legislation include: (i) click-through nexus legislation; (ii) use tax reporting legislation; and (iii) unilateral "*Quill* is dead" legislation.

1. Legislation

a. Click-through nexus laws

A click-through nexus law was first passed by New York in 2008[13] and at least twelve states[14] have subsequently enacted laws with similar approaches, but with slightly different terms and applicability. These laws typically provide that in-state website operators create a sales tax

[12] Efforts are underway by the Multistate Tax Commission ("MTC") to draft yet another version of nexus-expanding legislation, even in the face of ongoing litigation over the validity of such legislation. *See* the MTC's Sales and Use Tax Nexus Model Statute Project, http://www.mtc.gov/Uniformity.aspx?id=5890 (last accessed March 2, 2014).
[13] N.Y. Tax Law § 1101(b)(8)(vi).
[14] *See* Ark. Code Ann. § 26-52-117; Cal. Rev. & Tax. § 6203(c)(5); Conn. Gen. Stat. § 12-407(a)(12)(L); Ga. Stat. Ann. § 48-8-2(8)(M); 35 ILCS §§ 105/2 and 110/2; Kan. Stat § 79-3702(h)(2)(C); Me. Rev. Stat. Ann. § 1754-B(1-A)(C); Minn. Stat. § 297A.66, Subd. 4a; Mo. Rev. Stat. § 144.605(2)(e); N.Y. Tax Law § 1101(b)(8)(vi); N.C. Gen. Stat. § 105-164.8; R.I. Gen. Laws § 44-18-15; Vt. Stat. Ann. tit. 32, § 9701(9)(I) (H.B. 436).

collection obligation for remote sellers if all operators in the state collectively refer a threshold amount of sales (usually $10,000 over a calendar year) to the remote seller through links on their websites and are paid by commission. Once the obligation is triggered, the seller must collect tax on all sales into the state, not just on the sales resulting from the website operators' referrals.

The click-through legislation attempted to work within the framework set by *Quill*, in that it was an attempt to further define what physical presence consisted of in a state, in this case, that in-state web operators created physical presence for remote sellers. However, the precedent set by this legislation is somewhat disturbing in that it targeted an innovative marketing arrangement that helped compensate self-made bloggers and website operators which very often are small businesses and startups. The response by remote sellers in some jurisdictions was to end these marketing arrangements, harming an important nascent industry. The click-through legislation clearly demonstrates what happens without a Congressional framework, in that states undermine, or at least add burdens to, creative business ideas unique to remote sellers and impose tax obligations based on those ideas without any accompanying reforms to simplify the tax law or protect businesses.

b. Use Tax Reporting Requirements

The next evolution in anti-*Quill* legislation did not even attempt to work within the framework of *Quill*, and instead attempted an end-run around the case. Use tax reporting requirements were first passed by Colorado in 2010[15] and at least four states[16] subsequently enacted similar laws, again with varying terms and scope. The use tax reporting legislation was an attempt to address the issue of collecting use tax from consumers. As members of this committee are aware, the question of sales tax collection by remote sellers is not a question of whether the tax is owed or not, but rather whether the remote seller is required to collect the tax from the consumer. Under state sales and use tax laws, the consumers still owe the tax, though enforcement of that liability against individual consumers is extremely difficult.

[15] Colo. Rev. Stat. § 39-21-112(3.5)(d).
[16] Ky. Rev. Stat. Ann. § 139.450; 68 Okla. Stat. § 1406.1; S.C. Code Ann. §§ 12-36-2691(E), -2692; S.D. Codified Laws § 10-63-2.

The use tax reporting laws are purportedly designed to give states the tools and information needed to collect the use tax from consumers. The laws require remote sellers to provide a number of tax notifications and reports to their consumers and the states, and impose penalties if those notifications and reports are not filed. For example, Colorado's law requires notifications to be provided to consumers regarding the consumers' use tax obligations each time sales are made, as well as annual reports to be provided to consumers and to the state setting forth the amount of taxable products sold to consumers during the course of the preceding year. In reality, although the law might appear to be designed to gather information on consumers for purposes of enforcing use tax, in practice it makes compliance so onerous that companies will simply surrender their constitutional right and begin collecting sales and use taxes rather than dealing with the reporting requirements.[17]

c. "*Quill* is Dead" Legislation

If click-through legislation attempted to work within the *Quill* framework and use tax reporting legislation attempted to bypass the *Quill* framework, then the third type of anti-*Quill* legislation attempts to run through *Quill* as if it no longer exists. In 2010, Oklahoma passed legislation that listed all of the steps it had taken to simplify its sales and use tax system, and declared that its tax system no longer presented an "undue burden" on interstate commerce and that any and all remote sellers are required to collect sales and use tax on sales made into the state.[18]

As background, under the U.S. Supreme Court's "Dormant Commerce Clause" jurisprudence, absent specific Congressional action a state may not take action that imposes an undue burden on interstate commerce.[19] Under *Quill* and related decisions, the U.S. Supreme Court has held that the imposition of a sales and use tax collection obligation on remote sellers

[17] Even Phil Horwitz, the Colorado Department of Revenue's tax policy director said he "thinks most retailers would simply choose to collect the tax to avoid the more unpleasant option of having to send tax notices to their customers." Colleen Slevin, *Colorado Considers New Tactic to Tax Online Sales*, The Denver Post, February 8, 2010, available at http://www.denverpost.com/ci_14359737.
[18] 68 Okla. Stat. § 1407.5.
[19] *See, e.g. Quill Corp.*, 540 U.S. at 305-6.

with no physical presence was such an undue burden. Under its 2010 legislation, Oklahoma has declared that its sales and use tax law is so simple that sales tax can be imposed on any interstate sales without creating an undue burden. This is, of course, unconstitutional because the Supreme Court has routinely held that taxation of remote sellers requires physical presence.[20] Under *stare decisis*, the imposition of Oklahoma's sales tax collection obligation on remote sellers is unconstitutional, even if it had the simplest sales tax in the world. Furthermore, the U.S. Supreme Court's decision in *Quill* was based on the complexity inherent in complying with differing rules in multiple jurisdictions; a single state cannot unilaterally simplify a multistate system.

Fortunately, Oklahoma has not yet attempted to enforce this law. Unfortunately, Oklahoma is not the only state that could take this position. Oklahoma is one of twenty four SSUTA member states. Oklahoma's statutory claim is based, in part, on its implementation of simplification provisions under the SSUTA. Other states that are parties to the Agreement could similarly argue, even without a relevant statute, that their sales and use tax regimes do not create undue burdens on interstate commerce.

State tax policy discussions of late have included observations regarding states pursuing a strategy of assessing and litigating. If no federal framework is adopted it should come as no surprise when the SSUTA states collectively act as if *Quill* is no longer a restriction. Remote sellers facing assessment by twenty-four states with similar statutes will be forced to either commence litigation or surrender their constitutional rights and begin collecting tax on remote sales. Non-SSUTA states could also take the position that their sales tax is "simple enough" and begin assessing remote sellers. Only Congressional action can prevent the parade of horribles that would follow. If Congress does not act there will be little protection for businesses and much of the American economy: no guarantee of protection from aggressive audits; no provision requiring certification of commercial software as able to assist in collecting tax for all states; and

[20] Stephen P. Kranz, Lisbeth A. Freeman, Mark W. Yopp, *Is* Quill *Dead? At Least One State Has Written the Obituary*, 2010 STT 147-1, pp. 307-11 (August 2, 2010).

nothing to prevent the states from rolling back the simplifications that have already been achieved.

2. Aggressive State Policy and Remote Seller Audit Risk

Outside of the legislative arena, many state revenue agencies take aggressive policy and audit positions regarding what activity meets the *Quill* physical presence test. These positions are often not documented or set forth in written guidance, which makes it easy for states revenue agencies to adjust and modify these positions as needed to fit them under existing statutes. For example, a revenue authority in a state that has not expressly adopted click-through nexus legislation may nevertheless take the position that general case law is sufficient to require click-through based collection. Such ad hoc policy and audit decisions catch both large and small vendors in the compliance and liability risk net and cause confusion for consumers.

The Bloomberg BNA Annual Survey of State Tax Departments contains examples of the theories that various state tax departments have considered when arguing a remote seller has nexus, even in the absence of an explicit statutory provision.[21] The Survey demonstrates the varied, inconsistent, and confusing positions taken by states, compounding the burden on remote sellers. For example, Florida says that selling gift cards in the state creates nexus, while Texas does not. On the other hand, Texas says that a remote seller has nexus if it attends a trade show in the state, even if no sales are made at the show and no orders are taken, but Florida says that trade show activity does not create nexus.[22] Facing the possibility that it may have liability for failing to collect tax under these wildly inconsistent and varied theories, what should a remote seller do?

[21] Bloomberg BNA, *2013 Survey of State Tax Departments* ax Management Multistate Tax Report, Vol. 20, No. 4 (April 26, 2013).
[22] *Id.* A perusal of the survey exposes many additional views on what constitutes nexus-creating activity. Some states have indicated in the survey response that the following activities create a sales tax collection requirement for remote sellers: making "sales to customers in [the] state by means of an 800 telephone order number and advertis|ing] in |the| state"; "the corporation is listed in the local telephone books of cities in |the| state"; "maintaining a bank account in the state"; and "the corporation makes remote sales into [the] state and hires a third party to post informational content on in-state websites or blogs."

C. Consequences of Congressional Inaction and State-Specific Legislation

If Congress does not act, states will surely continue to pursue constitutionally suspect attacks on remote sellers. This trend will accordingly cause increasing problems and burden on business. First, the threat of assessment and litigation results in uncertainty, audit exposure, and direct cost to business and much of the American economy. Second, the evolution and disparity in state approaches makes it nearly impossible for businesses to understand their tax obligation. Finally, consumers will face a growing risk of state use tax enforcement.

1. Increased Litigation

The states' varying responses to the sales tax collection problem for remote sales have generated, and will continue to generate, a significant amount of litigation. Remote sellers are at an inherent disadvantage in litigating these issues. This litigation creates significant costs for those who choose to fight and creates significant uncertainty for all businesses while the litigation and any subsequent appeals are ongoing.

The click-through nexus laws have been challenged in New York and Illinois. In New York, two companies, Amazon.com and Overstock.com,[23] litigated the validity of the law and lost in the New York Court of Appeals (New York's highest court), and were turned away by the U.S. Supreme Court when it denied a petition for certiorari. In so doing, the U.S. Supreme Court implicitly reaffirmed its long-held position on this matter: it has addressed the issue twice, in *Bellas Hess* and again in *Quill*, and any additional action should be taken by Congress. The court in Illinois on the other hand held in favor of remote sellers and invalidated a similar, yet different, law.[24] Given the uncertainty and the possibility of inconsistent decisions in many states over the validity of similar laws, what should remote sellers do?

The use tax reporting laws have also led to litigation. In Colorado, the Direct Marketing Association (DMA) filed suit in federal court challenging the reporting regime. The DMA was

[23] *Overstock.com, Inc. v. New York State Dept. of Tax. and Fin.*, 987 N.E.2d 621, 20 N.Y.3d 586 (2013), *cert. denied* 134 S.Ct. 682 (2013).
[24] *Performance Marketing Association v. Hamer*, 998 N.E.2d 54, 375 Ill.Dec. 762 (2013).

successful in obtaining an injunction against the law from the federal district court, but the Tenth Circuit ruled that federal courts did not have authority to hear the case.[25] The DMA subsequently re-filed the case in state court and obtained an injunction at the state court level.[26] The state court litigation and a potential appeal of the Tenth Circuit decision are ongoing. This litigation has taken more than three years so far with no resolution apparent in the near term. In the meantime, every decision by a court has required vendors to determine whether they need to start complying with the law and how fast such compliance must be accomplished. Compliance requires significant system changes to collect and turn over the data required by statute; it is not merely flipping a switch.

If Congress continues to allow states to act with no guidance, states can, and ultimately will, continue to enact legislation and adopt policies that will seek to require remote sellers with limited resources to collect sales tax. Not everyone has the resources to challenge the constitutionality of such legislation and policies. The result will be more litigation, more costs for those that cannot litigate, and more uncertainty for everyone.

2. Increasing Uncertainty for Remote Sellers and Consumers

The absence of Congressional action addressing sales tax collection obligations on remote sellers is resulting, and will increasingly result, in frustrating uncertainty for remote sellers and consumers. The areas in which this uncertainty will manifest are myriad. For example, as noted above, the Colorado use tax reporting regime litigation has led to repeated questions as to when and if remote sellers must start complying. The same can be said of the click-through legislation. Their scope, applicability, and constitutionality are the subject of weekly client inquiries, from companies large and small, seeking to know whether they have tax obligations that must be met. There are rarely easy answers to such questions and the uncertainty inevitably inhibits business decision making and expansion and imposes unpredictable audit exposure.

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[25] *Direct Marketing Assoc'n v. Brohl*, 735 F.3d 904 (10th 2013).
[26] *Direct Marketing Assoc'n v. Colo. Dept. of Rev.*, Col. Dist. Ct.-Denver, Dkt. 13CV34855 (Feb. 18, 2014).

Consumers are also harmed by the lack of clarity regarding their tax obligations. While legally it is clear that consumers owe tax on purchases when the seller does not collect tax at the time of sale, consumers often do not understand that they are not following the law by failing to remit such tax. Those that try to comply are faced with a complicated, time consuming, and inefficient task – tracking all of their purchases where tax was not collected, determining whether each item purchased was in fact taxable, determining the appropriate tax rate, calculating and remitting the proper amount of tax. Tax friends of mine keep spreadsheets of their individual purchases to do the math. It's absurd that in today's modern economy we don't have an App for that. In reality, we do have a solution, and it is being used by companies that collect tax today, but without a uniform requirement of collection, consumers are faced with the tax calculation burden.

Without Congressional intervention in the issue consumers also face a growing risk that their personal information will be the subject of government inquiry. While states today do not routinely audit consumer buying to determine whether tax was paid, states have the authority to do so. Whether obtained by auditing an individual or, as in the case of Colorado, by mandating that sellers disclose their consumers and their consumers' purchases, it is clear that consumer information we all expect to be kept private is considered necessary by states for their use tax enforcement efforts. Consumer privacy should not be allowed to be imperiled by states driven to action in the absence of a federal solution.

IV. Congressional Action Is Needed to Protect Businesses, Consumers, and the States

In addition to avoiding the problems identified above, Congressional action establishing a framework for collection of state and local sales tax within the existing sales tax system would promote additional important policy benefits. One of those benefits is the preservation of state sovereignty. Another benefit is that Congress can create a framework designed to ensure that remote sellers have the information and certified commercial software needed to comply with all states sales tax laws, thus keeping the burden of tax compliance from being placed on consumers. Despite what some have argued, the technology and software that is available today

offers remote sellers the ability to collect and remit sales and use taxes in an efficient, seamless manner.

A. Preservation of State Sovereignty

Forty-five states have made the sovereign choice to fund government by imposing a sales tax on consumption by their residents. As Internet sales continue to erode the sales tax base, those states that have relied on a consumption tax regime are at risk of losing the ability to continue that policy choice. To maintain even a steady level of funding, states are being forced to rely instead on taxing income and property.

As Congress considers whether to act to address the issue of sales tax collection by remote sellers, some states have passed legislation that is at least partially contingent on revenue that would arise from federal legislation to overturn *Quill*.[27] For instance, in 2013 Virginia enacted a transportation funding bill that, among other actions, altered the state's tax on fuel. If federal legislation is not enacted to enable sales tax collection from remote sellers by January 1, 2015, then there is an automatic increase to the Virginia fuel tax rate. The 2013 Ohio and Wisconsin budget bills would direct revenue received as a result of federal legislation to reduce those states' income taxes. A bill is currently pending in the Idaho House of Representatives that would fund a tax relief fund with tax collected as a result of passage of the Marketplace Fairness Act.[28] In 2013, a Utah bill was enacted that would create a restricted account for sales tax revenue from remote sellers, and provides that the legislature may reduce local and state sales and use tax rates based on the revenue collected in the account.[29] Furthermore, in other states, state legislators have proposed similar bills[30] and governors[31] are signaling that they would use

[27] H.B. 1515, 2013 Gen. Assem., Reg. Sess. (Md. 2013) (enacted); H.B. 59, 130th Gen. Assem., (Ohio 2013) (enacted); H.B. 2313, 2013 Gen. Assem. (Va. 2013) (enacted); A.B. 40, 2013 Leg., (Wis. 2013) (enacted).
[28] H.B. 593, 62nd Leg., 2nd Reg. Sess. (Idaho 2014).
[29] S.B. 58, 2013 Leg., Gen. Sess. (Utah 2013) (enacted).
[30] H.B. 2465, 51st Leg., 2nd Reg. Sess. (Ariz. 2014); H.B. 2730, 2014 Leg., 2014 Sess. (Kan. 2014); H.B. 137, 2014 Leg., Reg. Sess. (Ky. 2014); S.B. 1424, 108th Gen. Assem. (Tenn. 2014); H.B. 224, 2014 Leg., Gen. Sess. (Utah 2014); H.B. 218, 2014 Leg., Gen. Sess. (Utah 2014). Note that as of this writing, the Arizona bill and Utah H.B. 224 failed to pass their respective legislative bodies.
[31] The governors from Iowa, Maine, and Rhode Island have all indicated they intend to reduce taxes once their states receive revenue from sales tax imposed on remote sales. *See* http://thehill.com/blogs/on-the-money/domestic-

revenue from federal legislation to decrease taxes. In particular, Tennessee Governor Bill Haslam, along with Tennessee House Speaker Beth Harwell and Tennessee Senate Speaker Ron Ramsey, have expressed support for the Marketplace Fairness Act and indicated that the revenue generated from federal legislation would be used to reduce current state taxes.[32]

Only Congress can prevent the erosion of the states' sovereign ability to make tax policy decisions by creating a framework for sales tax collection in the modern era. In creating a framework for sales tax collection Congress should similarly shy away from those alternatives that would cause a radical departure from existing state consumption tax systems. Some of the proposals you will hear today would trample state tax policy decisions put in place by Legislatures and Governors in each state and have far-reaching economic impacts.

Origin sourcing, with or without a redistribution compact, turns our state consumption tax system into a tax on production and suffers from constitutional infirmity. A 1099-style reporting regime for consumer purchases threatens consumer privacy in a manner that I hope you find as unappealing as the option of banning interstate commerce altogether. These are not alternative solutions to the Internet sales tax issue – they are proposals that would undermine state sovereignty and wreak havoc on business and consumers alike.

Congress' role under its Commerce Clause authority should acknowledge and preserve state sovereignty. Only by affirmatively addressing the remote sales tax authority question can Congress sustain the ability of states – like Texas, Tennessee, Florida, South Dakota, and Washington – to choose to rely on the sales tax so heavily. Without it those states should be preparing to impose an income tax.

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taxes/305223-iowas-gop-governor-lobbies-for-online-sales-tax-bill (last visited March 9, 2014) *and* http://www.rila.org/news/topnews/Pages/TheMarketplaceFairnessActIsPro-GrowthLegislation.aspx (last visited March 9, 2014); Letter from Gov. Branstad to Rep. Steve King (June 12, 2013) *available at* http://www.standwithmainstreet.com/getobject.aspx?file=lettertohousedelegation; Letter from Gov. LePage to Sens. Snowe and Collins (Mar. 12, 2012) *available at* http://www.standwithmainstreet.com/getobject.aspx?file=Lepage.

[32] *Marketplace Equity Act of 2011: Hearing Before the Comm. On the Judiciary, House of Representatives, One Hundred Twelfth Congress, Second Session on H.R. 3179*, 112th Cong. (2012) (statement of The Honorable Bill Haslam, Governor of Tennessee, on behalf of the National Governors Association); Tom Humphrey, *Passage of Marketplace Act May Lead to Lower State Taxes in Tennessee*, KnoxNews, June 3, 2013, *available at* http://www.knoxnews.com/news/2013/jun/03/passage-of-marketplace-act-may-lead-to-lower-in/?print=1.

B. Creation of Congressional Framework

I applaud the principles issued by the Chair that provide guidance related to the imposition of tax on remote sales. Those principles outline a path for Congress to create a workable framework for collection of sales tax. By acting to establish a framework, Congress can ensure not only that state laws as applied to remote sellers do not become overly complicated, but also that states are required to give remote sellers the tools they need to comply with those laws.

A framework is needed. A framework that provides certainty to business, consumers, and the states. A framework that relies on state-provided information, certified commercial software, and protections for business. A framework that preserves state sovereignty. And, perhaps most important, a framework that protects the American economy and American jobs. All of these are achievable, and only by Congress.

V. Alternative Proposals

Below I briefly address each of the alternative solutions proposed today to address the Internet sales tax issue. Additional thoughts on some of the alternative proposals and other concepts related to the remote collection issue can be found in the Appendix to this testimony.

A. Option 1: SSUTA-Type Compact Governing Interstate Transactions Only

The only viable alternative being discussed today is one in which Congress creates a federal framework to address the Internet sales tax issue based on a compact among the states but which leaves intact the general ability of states to decide whether, and on what, to impose a sales tax. Whether that compact ties directly to the existing Streamlined Sales and Use Tax Agreement or offers a different set of simplifications, and whether the solution applies only to remote sales or to all sales are questions Congress can and should address. The question as to what are the best details of such a compact, however, does not alter the inherent reasonableness of adopting a system that provides simplification and protection to remote sellers, protection of states' revenue streams, and continued recognition of state sovereignty.

B. Option 2: Multistate Compact to Collect & Redistribute Sales Tax

You have been presented with a proposal that would have Congress develop and approve a compact based on an origin sourcing regime for remote sales coupled with administrative and redistribution provisions adopted from the International Fuel Tax Agreement ("IFTA"). This proposal suffers from all of the problems of an origin system and inherent in IFTA with the additional problems created by merging the two and limiting the rules to remote sellers.

In particular the proposal would, quite surprisingly, decouple the choice of how to tax a transaction from the jurisdiction receiving the benefit of the tax. It is the equivalent of letting France unilaterally decide whether the US will get tax revenue from a phone call between a woman in Ohio and her friend in Paris.

The proposal not only fails to fix the jurisdictional uncertainties currently faced by remote sellers, it aggravates them. This origin system would apply only in states where a particular remote seller does not have physical presence under *Quill*. As we know, it is frequently not clear whether a vendor has the requisite physical presence in a state. If a seller has physical presence, the proposal would leave the existing destination based tax calculation and remittance system in place. If the seller does not have the requisite physical presence, the origin state's rules will apply. As such, remote sellers operating in the all too frequent nexus gray area would be at risk that they collected an origin tax when they were obligated to collect the destination state's tax rate and apply the destination state's rules.

Furthermore, consumers will be confused because they will be subject to different tax rates based not only on where the vendor is located but also on whether the vendor is physically present in the state in which the consumer is located. Asking consumers to pay tax based on the proposed basis is no less absurd than asking them facts that are not under their control or understood to them is tantamount to asking them to pay tax

For remote sellers and their consumers, this proposal fundamentally changes the economic effect of the traditional state sales tax because the proposal converts a consumption tax regime into a production tax regime.

Finally, the proposal suffers from serious constitutional problems and would be inconsistent with the protections Congress afforded sellers in the Internet Tax Freedom Act, which prohibits states from imposing discriminatory tax rates on Internet-based commerce.[33]

C. Option 3: Require Reporting, Not Collection

If a national reporting regime for purchases is enacted, either remote sellers will acquiesce and collect tax to avoid the reporting burden or consumers will shoulder the burden of tax compliance. A national reporting regime would be more burdensome than today's sales tax collection obligation. While there are various alternative reporting regime concepts being discussed, each of them would cause significant problems. Whether the proposal considered utilizes a Colorado-type approach where vendors turn over data about consumers directly to the government or an approach where the vendor and software companies work to turn over data to the government, each approach shares fundamental problems.

Any reporting regime would create significant privacy concerns as remote sellers would be required to provide detailed information about each of their consumers and their purchases to allow states to enforce use tax. Whether this information is maintained in a national database or by individual states, the threat to privacy is clear.

To defend the proposal by arguing that it would not be necessary to capture and maintain information about specific purchases undermines the workability of the proposal. Without that information, it will be impossible for consumers to comply with their use tax obligation or for states to enforce it. Under a reporting regime, if a state audited a consumer for use tax compliance, the state and the consumer would have to know what items were purchased by the consumer (and the dollars spent), whether those items were taxable, and whether the vendor had

[33] 47 U.S.C. § 151.note.

charged tax. In current audits, because the audit is of a seller, the identity of purchasers is not typically needed to audit the seller's taxability determination. The only information needed is whether the seller appropriately treated the product as taxable or not. The reporting regime approach thus threatens to expose personal consumer purchasing information in an unprecedented manner.

Concerns over the capture, transmittal, and maintenance of data regarding consumer purchases speak against the regime as a solution to the Internet sales tax issue. Whether the reporting captures individual items purchased by consumers, or vendor names that are selling to consumers, the potential for harm is clear. Again, it is important to note that without capturing that sensitive information, the regime would not work to allow use tax enforcement.

A version of the reporting regime proposal indicates that it would not be necessary to capture detailed information about consumer purchases. Instead, the proposal would require new software be developed to interface between vendors and the government to sanitize data such that the government did not receive detailed information.[34] It is unclear why sellers or the states would fund the software and integration costs for a system that did not result in tax being collected. It is also unclear how such an expense is justified under a system that still leaves tax compliance incomplete while threatening disclosure of consumer purchase information.

Rather than face the consumer privacy concerns and costs of a new reporting regime, some sellers are likely to choose to collect tax, doing so without any of the protections, uniformity and technology that would be addressed by a compact or framework that sets rules for sales tax administration.

Although consumers today have liability for use tax, states have not widely enforced the obligation because of auditing inefficiencies and/or political concerns; the reporting regime approach would unequivocally place the tax compliance burden on consumers. Should the proposal require sellers to report only gross sales, the taxability determination would be left up to

[34] http://www.floridasalestax.com/Florida-Tax-Law-Blog/2014/March/US-SALES-AND-USE-TAX-SYSTEM-NEEDS-FEDERAL-C-P-R-.aspx (last visited March 7, 2014).

the consumer. For exempt purchases, consumers would have the burden of documenting and proving that they were not subject to tax. Even if the states were to offer a theoretically standard exemption,[35] a consumer wanting to claim actual exempt purchases would have the burden to prove the exempt amount. This approach would burden all consumers and would significantly disadvantage the unsophisticated consumer. For instance, if a consumer makes significant purchases of exempt items such as clothing or food (frequently exempt in states), then that consumer would have to take the following steps: receive the report of their gross purchases, calculate the standard exemption, calculate her actual exempt purchases based on individual receipts and knowledge of the state's tax law, compare the two exemption amounts, file a return remitting use tax based on the greater of the two exemption amounts, and maintain all receipts and documentation to prove the exemption claimed for a potential future audit.

While the reporting regime approach would lead to audits of consumers, such enforcement of consumer liability would be inconsistent at best. Limited state resources would inevitably prevent states from effectively enforcing the law against all consumers. An additional consideration is that while some states require consumers to pay use tax in conjunction with their income tax filing obligation, not all consumers are required to file income tax returns.[36] These consumers would be forced instead to file a use tax return to report their liability or risk the threat of audit, interest and penalties. Budgeting and paying use tax annually may also be difficult for certain taxpayers that have historically relied on our federal and state tax withholding systems to ensure their compliance with the law. The approach erodes government efficiency by forcing states to audit individuals rather than making the seller responsible for tax collection.

D. Option 4: Grant States the Power to Exclude Instead of the Power to Tax

Congress' role should be to facilitate interstate commerce and ease the burden of tax collection on interstate sales, not to set up barriers to commerce and therefore impose harm on

[35] *Id.*
[36] A taxpayer could be not required to file an income tax return because his or her state does not have an income tax or because the taxpayer's taxable income does not exceed a certain threshold.

our country's economy. Even if such an approach were adopted there are serious questions about how it would be enforced. Would states be authorized to stop deliveries by common carriers and the U.S. Post Office? Buyers would be confused by their inability to buy from a company located outside their state. And for vendors who decided to collect tax, rather than suffer the prohibition on making sales, there would be no simplification, uniformity, protections or software tools made available to facilitate the effort. The harm to interstate commerce would be much more dramatic than a simple requirement to collect tax.

E. Option 5: Origin-based Collection

An origin-based collection regime would constitute a complete overhaul of the nation's existing sales tax system. This approach is so dramatic that it would likely result in the elimination of sales tax as a funding option for states. States that did not eliminate their sales tax would lose their business base as remote sellers set up operations in states without a sales tax. The threat of such economic disruption would likely convince most, if not all states to eliminate their sales taxes. No other country in the world uses origin sourcing for consumption tax purposes. I would also note that U.S. companies would be forced to collect sales tax on sales made to customers outside the U.S. and imports would be exempt from sales tax under such a proposal – obviously creating competitive problems for U.S. based businesses and an incentive for businesses to move off-shore.

VI. Conclusion

Congressional action creating a framework for remote sellers to collect sales tax is required to truly solve the Internet sales tax issue. In the absence of Congressional involvement, states have shown they will certainly try to solve the issue on their own; because their authority regarding interstate commerce is limited, their approaches will create even more problems for Internet vendors and consumers. Should Congress choose to squarely address the Internet sales tax issue, its framework should be built around existing state tax policy decisions and should not radically upend the sales tax regime as others would propose.

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March 12, 2014

Mr. Chairman, I again thank you for the opportunity to speak before this Committee today. I welcome questions from you and the Committee.

APPENDIX

Testimony of Stephen P. Kranz
United States House of Representatives
Committee on the Judiciary
March 12, 2014

Additional Analysis of
Option 2: Compact to Collect & Redistribute Sales Tax

- A hybrid approach that combines the redistribution and some of the administrative concepts of the International Fuel Tax Agreement ("IFTA") with origin based imposition and collection, and applies such a system solely to remote sales, is an approach with serious infirmities.
    - Even though IFTA contains admirable concepts (*e.g.*, a single return, redistribution and credits, a home state for registration), it still contains compliance and efficiency challenges.
        - IFTA requires customers, i.e. the truckers and trucking companies, to self-assess each state's tax based on the consumption that occurs in that state. A credit is given for any taxes paid to a vendor.
        - Thus, IFTA's concepts are not scalable from the limited-vendor, single-product environment of fuel sales where returns are filed by customers to the extensive economy of all types of remote sales and sellers where returns are not filed by customers but by the sellers.
    - Collecting tax based on the state of origin's laws creates harmful economic distortions by incentivizing businesses to make geographical decisions based solely on taxes.
    - Combining IFTA and origin-based collection only creates additional problems not intrinsic to each system on a stand-alone basis.

- The proposal would still have most of the problems associated with an origin based system, including the following that deserve particular note:
    - Under the proposed approach, taxability and tax rate would be determined based on where a seller's "home state" is located. When the seller's home state does not impose sales tax, the seller would charge no tax on the transaction even if one of the following is true: (1) the product was delivered to a purchaser in a state that would tax the purchase or (2) the purchased product would be used in a state that would tax use of the product.
    - Sellers in a state with a sales tax could decrease the total cost of their products to all consumers merely by relocating the location of their "home state." The proposed hybrid approach would allow remote sellers to easily manipulate their business model to ensure that the home state is a state without a sales tax.
        - If home state is based on state of incorporation, then retailers will just reincorporate in a state with no sales tax.
        - If home state is based on where products are shipped from, then retailers will locate or use warehouses in a state with no sales tax.
    - Companies could easily manipulate the home state by simply creating a separate entity in a home state that has no sales tax, to operate as the seller of record while other operations are carried on outside that state.

- The economic incentive on sellers to relocate to states without a sales tax would in reality force states to eliminate their sales taxes altogether, or accept harm to their economic climate and competitive disadvantage for in-state businesses.

- Coupling an origin collection rule with an IFTA redistribution arrangement adds additional problems to already undesirable options.
  - The proposal bifurcates the jurisdiction deciding whether and how to impose the tax from the jurisdiction that receives the financial benefits of the tax. Why would any jurisdiction that does not receive the benefit decide to impose a tax?
  - Under the hybrid approach, not only the tax rate, but also taxability is determined by the home state's laws. This strange approach would lead to confusion for consumers. Instead of consumers being subject solely to the laws of their own jurisdiction, they would be subject to the laws of every jurisdiction from which their purchases originate. For example, consumers used to buying clothing or food items tax free, because their state of residence allows an exemption for such goods, would lose this exemption when purchasing from a remote seller located in a state that taxes such goods.
  - The proposal is not consistent with sound economic theories because it imposes a tax based on production but distributes the benefits of the tax based on consumption.
    - The hybrid approach does not follow the policies supporting IFTA. IFTA is based on a theory that tax should be paid to the state where a product is consumed, which is why the tax is structured as an imposition on the customers who have knowledge of the consumption and not the vendors.
  - The hybrid approach only applies to remote sales, *i.e.*, sales made into a state by a seller without physical presence in that state. It thus perpetuates the jurisdictional issues of the current system caused by the physical presence rule and piles on confusion for the consumer.
    - Based on experience with the current system, it is frequently unclear whether a vendor has the requisite physical presence in a state. If a seller has physical presence, the proposal would leave the existing destination based tax calculation and remittance system in place. If the seller does not have the requisite physical presence, the origin state's rules will apply. As such, remote sellers operating in the all too frequent nexus grey area would be at risk that they collected an origin tax when they were obligated to collect the destination state's tax rate and apply the destination state's tax rules.
    - This approach will create confusion for consumers as some sellers will collect on a destination basis – if they have physical presence in the destination state; and some sellers will collect on an origin basis. Consumers will not know what tax will be collected on any given purchase until they checkout. Consumers will have no way to know

whether the purchase is subject to tax in the origin jurisdiction, or whether the tax rate being charged is correct.

- The hybrid approach will further complicate consumer use tax compliance.
  - While the approach provides that the seller will collect tax on the transaction, it appears that sellers would not be collecting the tax that is owed by the consumer and consumers would remain liable for any use tax differential. If the home state applies a tax rate that is lower than the rate imposed by the destination state, or the product is exempt in the home state, the consumer will continue to owe use tax on the transaction. Calculating the remaining use tax differential will be a tremendous burden on consumers.
- The hybrid approach will cause a tax increase for consumers.
  - Consumers would be liable for the greater of the tax charged on an origin basis or the use tax applicable in their state of residence. As a result, the consumers would face an increase in tax liability compared to their use tax exposure under the current system.

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United States House of Representatives
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Additional Analysis of
Option 3: Require Reporting, Not Collection

- A federally-mandated use tax reporting regime, such as the one adopted by Colorado, would: force remote sellers to collect sales tax without the protections of a Congressional sales tax collection framework; raise privacy questions; fail to prevent state anti-*Quill* legislation; require a massive new federal infrastructure; and impose a tremendous burden not only on consumers but also on all vendors.

- At least one version of the reporting regime proposals has preliminarily suggested the following elements:[37]
    - Remote sellers would be required to report sales information to a federal database, either directly or through software vendors.
    - The remote sellers and software vendors would determine the taxability of categories of products.
        - Alternatively, remote sellers and software vendors would provide gross sales, and each state would set a standard exemption for consumers to use based on the state's exemption laws. Consumers could file a return claiming a larger exemption and support it on audit.
    - The database would generate 1099-style reports that aggregate all remote sales information for a consumer. Information would be aggregated based on federal tax ID number, credit card number, and a new optional US sales tax identification number. It is not clear whether each vendor would generate a separate 1099-style report or whether all vendors would somehow be aggregated.
    - The information would be sent to the consumer and to the state.
    - If a consumer does not file a use tax return, states could send audit letters to those taxpayers.
    - Consumers could access their purchasing history, and provide that data only when needed to prove an exempt sale.
    - The federal government would set up standard information reporting for software vendors. The software vendors would be funded by the states, based on the volume of sales processed through the reporting system.
    - States would be able to audit software vendors and remote sellers to determine the accuracy of their taxability decisions.
    - Remote sellers with nexus would be required to collect tax; if a remote seller follows the reporting requirements while under the mistaken belief that it does not have nexus, once the mistake is discovered, the seller would only have a prospective obligation to collect tax and could not be held liable for tax on past sales.
    - *Quill* would be codified in statute.

[37] http://www.floridasalestax.com/Florida-Tax-Law-Blog/2014/March/US-SALES-AND-USE-TAX-SYSTEM-NEEDS-FEDERAL-C-P-R-.aspx (Last visited March 7, 2014).

- There could potentially be a small seller exception.

- This reporting regime proposal is problematic for many reasons:
  - Whatever the intention behind the proposal, it would likely result in remote sellers being forced to collect sales tax without the protections of a Congressional sales tax collection framework. Remote sellers would be faced with a choice: either provide annual (and probably per-transaction) notices to consumers informing them of use tax obligations, or collect tax from those consumers at the time of sale.
  - Consumers would be faced with a choice: either find a retailer that will collect sales tax at the time of purchase, or be forced to file use tax returns at the end of the year and be subject to audit.
  - To implement this reporting regime would require a massive new federal infrastructure.
  - To implement this reporting regime would require businesses to invest in new software and systems to track the necessary data. To the extent that states are required to fund the software, the proposal would raise unfunded mandate concerns.
  - To implement this reporting regime would require states to build out a sophisticated and expensive use tax enforcement program. To the extent that states are required to participate, such a requirement would raise unfunded mandate concerns.
  - The reporting regime proposal makes no allowance for exempt sales for resale; failing to exclude the resale transaction data from the database or reporting provision makes the data largely unusable and dramatically increases the likelihood that businesses buying for resale will be subjected to audit scrutiny unnecessarily.
  - The prospective-only correction mechanism included in the proposal is an invitation to game the system.
  - For consumers who buy from remote sellers operating under the reporting regime, this proposal has serious privacy implications. Although the proposal makes an attempt to sanitize information given to the states and federal government, it leads to a clear threat that consumer purchasing information will be disclosed to the government. Even if information on a product is sanitized, there could still be privacy issues that arise from identifying which vendors are making sales to a particular consumer.
  - The proposal would either require that consumer purchases be reported to the government or would require that they be disclosed on audit as states sought to enforce their use tax. Without information about individual purchases, the proposed regime would not be helpful to use tax enforcement.
  - Under current audits, states do not need, nor do they obtain, information on purchases by individual consumers. A vendor indicates whether it collected tax or not on sales of an item, and the state then determines if that taxability decision

is correct. A state typically has no need to determine what items were bought by an individual, just if tax was collected on those items by the vendor.

- The proposal increases the potential for identity theft by gathering tax ID information along with credit card information for every remote transaction. While the details of the proposal are not complete one can hardly imagine that mandating the accumulation of data in this manner would not make it susceptible to identity theft.
- Even if a reporting regime is in place, states will continue to push for an overturn of *Quill* or push for remote sellers to be deemed to have a physical presence in the state so that the remote sellers remit the tax and can be audited. Such an arrangement is much more palatable politically and economically for a state than enforcing a use tax obligation against its citizens.
- State enforcement of the use tax through a reporting regime approach would shift the full burden of tax compliance to consumers. In addition, the regime would create a new reporting burden on vendors.

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United States House of Representatives
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Additional Analysis of
Option 5: Origin-Based Collection

- Origin sourcing for a consumption tax is a quintessential example of taxation without representation. Under an origin regime, a purchaser pays tax to the jurisdiction of the seller – a jurisdiction with which the purchaser has no connection or representation. Purchasers would be paying to fund services that they would never receive and would lack the ability to affect that jurisdiction's tax legislation through elected representatives.

- As Professor Walter Hellerstein notes in his treatise, consumption taxes using destination sourcing promote neutrality by treating all goods consumed in a state in the same way, regardless of the shipment origination location. Hellerstein, *State Taxation*, ¶18.02[1].

- Origin sourcing is the nuclear bomb version of tax competition – it will in practice eliminate the sales tax as a source of state revenue. If origin sourcing is implemented, purchasers will have the immediate option of buying tax free from sellers in no-tax states. To compete, businesses located in states that impose a sales tax will demand that their states eliminate sales taxes, or the sellers will relocate to a state with no sales tax, or to another country. States will be forced to eliminate sales and use tax as a vehicle for government funding to "compete" with the states that have designed their tax system without a sales tax.

- No country in the world that imposes tax on consumption uses an origin sourcing approach, in part because origin sourcing gives a clear tax preference to imports from foreign sellers. These sellers will not have to collect sales tax, and, as noted, domestic companies will be forced to relocate to compete. U.S. companies will still have to collect tax on sales made to foreign jurisdictions, which all use destination sourcing.

- Origin sourcing is tantamount to a federal mandate to eliminate sales and use tax, impinging on important sovereign state tax policy choices. Every state and locality has made very specific decisions on how to fund government services, using many different tax and fee options. State and local governments would no longer be able to choose to tax consumption. Congress will have stripped them of that possibility by making it economically disastrous to do so. Further, to offset for lost revenue, states will increase other taxes imposed on their residents, such as property taxes and personal income taxes.

- Origin sourcing would result in chaos and confusion for purchasers. Instead of a purchaser paying one tax rate based on where he or she lives, the purchaser would pay tax based on the rate applicable in the shipped-from location, over which the purchaser has no control and no understanding.

- Origin sourcing will either violate the Due Process Clause or will require a massive restructuring of the existing sales and use tax system. If Congress only requires that

states use origin sourcing without mandating a fundamental change in state sales and use tax imposition, this will result in the vast majority of states sales and use tax statutes being in violation of the minimum contacts requirement of the Due Process Clause. *See Daimler AG v. Bauman*, 571 U.S. ___ (2014); *International Shoe Co. v. Washington*, 326 U.S. 310 (1945). Most states place the legal incidence of the sales tax on the purchaser; the seller is only required to collect the tax from the purchaser and remit it to the state. Mandated origin sourcing, without changing the legal incidence of the tax from the purchaser to the seller, would violate the Due Process Clause because in most cases the purchaser would not have the necessary connection with the state of origin for that state to exert its taxing jurisdiction over the purchaser. The purchaser would merely be ordering something with no knowledge or interest in what state the product would originate – and thus be taxed. The only other option is, in the wake of a Congressional origin sourcing mandate, for every state to change its use tax statute imposed on the purchaser to a sales tax statute imposing the tax on the seller. This not only raises significant logistical legislative challenges, but also raises issues regarding to what extent could a seller specifically pass-through the tax to a purchaser. Thus, absent a mandate that states legislatively alter the party on which the tax is legally imposed, a congressionally mandated origin sourcing regime would be constitutionally infirm.

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Additional Discussion:
Due Process Issues

- Any legislation, regardless of its subject matter, is subject to Due Process protections. There is nothing about legislation overturning *Quill* that raises unique Due Process problems.
    - *Quill Corporation v. North Dakota*, 504 U.S. 298, 305 (1992).

- As Professor Walter Hellerstein noted in his treatise, "Congress possesses unquestioned power under the Commerce Clause to regulate state taxation of interstate commerce." Hellerstein, *State Taxation*, ¶4.24. The U.S. Supreme Court invited Congress to act on this issue, and noted that while Congress had full power to regulate interstate commerce, Due Process protections would remain, regardless of Congressional action. *Quill Corporation v. North Dakota*, 504 U.S. 298 (1992). Congress has the ability to establish the framework necessary to ensure remote sellers are able to collect all state's sales and use taxes, while minimizing any undue tax burdens of complying with such system based upon the simplifications and protections set forth in the federal legislation.

- The Due Process Clause requires a person to purposefully avail themselves of a forum state before being subject to personal jurisdiction (or taxes) in the state. *International Shoe Co. v. Washington*, 326 U.S. 310 (1945). The Third Circuit has held that "mere operation of a commercially available web site" does not show that an operator purposefully availed itself of a forum state. *Toys "R" Us, Inc. v. Step Two, SA*, 318 F. 3d 446, 454 (2003). **However**, in the same case the Third Circuit held that "[i]f a defendant web site operator . . . knowingly conducts business with forum state residents via the site, then the "purposeful availment" requirement is satisfied." *Toys "R" Us, Inc.*, 318 F. 3d at 452.
    - If a remote seller is operating a website accessible in a state and transacting business with a purchaser, then the remote seller has likely purposefully availed themselves of the jurisdiction.

- A congressional grant under the Commerce Clause of jurisdictional authority to states is not a new concept and has been successfully implemented in the past – with few due process problems.
    - McCarran-Ferguson Act – removes Commerce Clause restrictions on interstate regulation of insurance, including state taxation of insurance companies.
    - Mobile Telecommunications Sourcing Act – establishes the jurisdiction able to tax cellphone usage and related services.

- When it comes to Congressional regulation of state taxes, a Due Process violation could occur only if a state improperly exercised the authority allowed by Congress. The risk of state Due Process violations exists today and is not exacerbated or enhanced by Congressional action.

- The PACT Act is not analogous to the existing proposals for Congress to overturn *Quill*'s Commerce Clause limitations. Unlike proposals to overturn *Quill*, the PACT Act placed an affirmative burden on businesses by requiring them to comply with state and local tobacco tax laws on remote sales as if the sales occurred in a state. 15 U.S.C. § 376a. The PACT Act created a jurisdictional fiction; this jurisdictional fiction is what created the Due Process problems and that fiction does not exist in the efforts to have Congress overturn *Quill*.
    - Furthermore, the PACT Act litigation arose in a different context than the hypotheticals used against legislation to overturn *Quill*. The PACT Act litigation involved businesses seeking to enjoin the federal statute from deeming a sale to have occurred in a state regardless of the actual contacts with the state. I am unaware of any examples where a state has sought to justify enforcement of its tobacco tax laws on a remote seller in violation of Due Process by invoking the PACT Act.

Testimony of Stephen P. Kranz
United States House of Representatives
Committee on the Judiciary
March 12, 2014

Additional Discussion:
One Rate Per State for Remote Sales

- A one-tax-rate-per-state requirement would force at least half of all local governments to raise their tax rates. In states that allow localities to impose local sales tax, each locality chooses the tax rate applicable to consumers in that jurisdiction. Requiring localities to all adopt the same tax rate (the implicit mandate of a one rate tax system) would force localities with a lower tax rate to raise their rate such that all localities had the same tax rate, leading to a rate that equaled the "highest common denominator."

- Tax rates applicable to consumers who live in a city, county or other jurisdiction should not be determined by federal legislation. Local political processes are in place to establish tax rates applicable to constituents who live in those jurisdictions. It is those constituents who rely on government services and who should have a say in the rate applicable to their purchases. Congressional interference with state and local tax rates would impinge on the political sovereignty of state and local governments in a way that disrupts decision-making for important local programs.

- A one-tax-rate-per-state requirement would impose a new burden on purchasers to track the difference between the rate collected by a remote vendor and the actual combined state and local rate applicable to the transaction. If the actual combined state and local tax rate exceeds the rate collected by a remote vendor, the purchasers would have an obligation to pay the difference as a use tax liability on their purchase – unless Congress also mandated the elimination of use tax as it is known today. The additional tax obligation would require purchasers to track whether their vendors were collecting the actual state and local tax rate or were collecting under the one rate regime. Purchases made from remote sellers operating under the one rate regime would be subject to additional use tax exposure analysis. Purchases made from sellers that had pre-existing nexus would be taxed at the actual state and local rates. Consumers would have to track each purchase to determine which method was used and whether additional use tax was owed.

- Imposing two different tax rate rules on a vendor based on whether that vendor had nexus in the destination jurisdiction would be more administratively burdensome than today's tax regime – it would require vendors to maintain two types of tax collection, reporting, and remittance.

Mr. GOODLATTE. Thank you, Mr. Kranz.
Mr. Moschella, welcome. Welcome back to the Committee.

TESTIMONY OF WILLIAM E. MOSCHELLA, SHAREHOLDER, BROWNSTEIN HYATT FARBER SCHRECK, LLP

Mr. MOSCHELLA. Mr. Chairman, Ranking Member Conyers, Members of the Committee, I appreciate the opportunity to testify and to come back before the committee that I was so privileged to serve for so many years.

We represent Simon Property Group, the largest owner/operator of shopping malls in the United States. The Simon Property Group stands with the broad coalition that supports the Marketplace Fairness Act. However, when Chairman Goodlatte indicated concerns about the Senate-passed version of the bill, Simon Property wanted to be responsive. In that spirit, we offer our idea to assist the Committee as it considers remedies for what most agree is a fundamental unfairness.

At its core, the Marketplace Fairness Act would authorize States to require remote sellers to collect and remit State sales taxes to the receiving State. Another option would be to enact a Federal law prohibiting the shipment of goods in violation of the sales tax laws of the receiving State. This is very similar to what Congress did in the 1913 Webb-Kenyon Act concerning the regulation and taxation of alcohol. In 2000, Congress reaffirmed and strengthened Webb-Kenyon by enacting an enforcement provision giving States the ability to seek injunctive relief in Federal court for violations of Webb-Kenyon, including the failure of remote sellers of alcohol to collect State sales and excise taxes.

The Webb-Kenyon model is simple. It is constitutional. It authorizes no new taxes. It recognizes the sovereign nature of State taxing decisions. It would not allow discriminatory State sales taxes. And this concept was reaffirmed by wide bipartisan majorities approximately 14 years ago.

In my written statement, I detail the history of Webb-Kenyon, which was a response to the changing commerce clause jurisprudence of the time. What is important to note from that recitation is as follows: State regulation of alcohol was not always the norm. The ability of States to regulate alcohol has ebbed and flowed between the States and the Federal Government as the Supreme Court's commerce clause jurisprudence has changed.

Prior to the enactment of Webb-Kenyon, the Supreme Court in *Leisy v. Hardin* would not even allow a facially-neutral Iowa dry State statute to prevent the direct shipment of beer to an Iowa consumer. I thought that would interest Mr. King. In response, the politically powerful temperance movement moved to convince Congress to pass Webb-Kenyon, which filled what was regarded as a direct shipment loophole. In holding that Webb-Kenyon was constitutional, the Supreme Court observed that the act prevented "the immunity characteristic of interstate commerce from being used to permit the receipt of liquor through such commerce in States contrary to their laws."

In the same way that Webb-Kenyon eliminated the regulatory advantage obtained through the immunity characteristic of the commerce clause, this Committee is considering ways to eliminate

the regulatory advantage enjoyed by remote sellers under contemporary commerce clause jurisprudence. In 2000, Congress reaffirmed and enhanced Webb-Kenyon when it enacted the 21st Amendment Enforcement Act. Congress permitted a State attorney general to seek injunctive relief against anyone the State had reasonable cause to believe violated that State's liquor laws. This, of course, includes State tax laws. Today's debate about how best to help States enforce their sales tax laws is reminiscent of the debate over the Enforcement Act.

The House Committee on the Judiciary's report on the bill observed that with the advent of the internet, numerous direct sellers had entered the alcohol market. In addition to the concern about underage purchasers receiving direct shipments of alcohol, the Committee report emphasized concern that direct shippers of alcohol were avoiding State taxes. "Illegal direct shipments also deprive the State of the excise and sales tax revenue that would otherwise be generated by a regulated sale."

In fact, one of the key Federal court cases cited by the Committee in its report justifying the need for the Enforcement Act involved the State of Florida's allegations that an out-of-State direct shipper failed to pay excise taxes, sales taxes, and license fees. During a hearing on a similar bill in 1997, Members of this Committee heard testimony from the sponsor of the legislation, State officials, and industry supporters who all agreed that circumvention of State tax laws were a driving concern justifying the act.

Likewise during floor debate, Members of the House raised these same State tax collection concerns. In addition, the chief Senate sponsor of the Enforcement Act, Senator Hatch, discussed the lost tax revenue generated by the sale of liquor from out-of-State direct shippers.

The record could not be any clearer that one of the primary drivers of the Enforcement Act was the inability of States to enforce their rights under Webb-Kenyon to collect State taxes from out-of-State shippers. Interestingly, all of the elements of that debate—internet retailers, direct shipments, the failure to collect State taxes—are all at work here. That is why Webb-Kenyon and the Enforcement Act are an applicable precedent upon which to build a solution.

Mr. Chairman and Members of the Committee, we hope this idea helps generate thought and discussion about the best way forward to solve the critical disparate tax treatment of remote and in-State sales. I look forward to your questions.

[The prepared statement of Mr. Moschella follows:]

Brownstein Hyatt
Farber Schreck

Testimony of

Mr. William E. Moschella, Shareholder
Brownstein Hyatt Farber Schreck, LLP

on behalf of
Simon Property Group

House Committee on the Judiciary

Hearing on
"Exploring Alternative Solutions on the Internet Sales Tax Issue"

March 12, 2014

410 Seventeenth Street, Suite 2200
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Mr. Chairman, Ranking Member Conyers, and Members of the Committee, my name is Will Moschella,[1] and I appreciate the invitation to testify today as you continue to explore ways in which Congress can assist states collect sales and use taxes that are due under current state law.

We represent Simon Property Group, the largest owner/operator of shopping malls in the United States with 351 properties in 38 states and Puerto Rico. Over 420,000 employees work at Simon Property shopping malls and Simon tenants remit $4.6 billion in sales taxes and $608 million in property taxes to support the local economies where Simon properties are located. It is the firm opinion of David Simon, CEO of Simon Property Group, that congressional inaction on this issue will cause a serious downturn in the U.S. economy and that it is of tantamount importance to find a solution that can pass the Congress and be signed into law. He believes that there must be a level playing field regarding the tax treatment of internet sales and brick-and-mortar sales. The current situation; in his opinion, is absolutely untenable and Congress must enact a remedy.

The Simon Property Group fully supports the Marketplace Fairness Act as passed by the Senate. Simon Property is a member of the Marketplace Fairness Coalition, the International Council of Shopping Centers, and the National Association of Real Estate Investment Trusts, all of which support the Marketplace Fairness Act. The Marketplace Fairness Act is a well-considered, bipartisan proposal which enjoys the support of a wide coalition, including Governors, brick-and-mortar retailers, and Internet-based retailers. However, when Chairman Goodlatte indicated concerns with the Senate-passed version of the Marketplace Fairness Act, Simon Property endeavored to find other approaches that could address those concerns and still achieve the fundamental purpose of the Marketplace Fairness Act. If other effective ways to address the inequity in the current system can be supported by the vast stakeholders in this matter, Simon Properties will help lead the effort to forge consensus and move it forward. We offer our idea to be constructive and to assist the Committee as it considers remedies for what most agree is a problem that must be solved. In that spirit, Simon thanks the Chairman for calling this hearing to explore alternatives, and we are pleased to discuss an idea we think could satisfy the principles the Chairman released in 2013.

Injunctive Relief for Failure to Comply with State Sales Tax Laws

At its core, the Marketplace Fairness Act would authorize states to require remote sellers to collect and remit states sales taxes to the state to which goods are sent. Such legislation is needed because the Supreme Court has interpreted the Commerce Clause to prevent states from doing this on their own.

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[1] Mr. Moschella is a Shareholder at Brownstein Hyatt Farber Schreck LLP. Before joining the firm in 2008, Mr. Moschella served at the Department of Justice as the Principal Associate Deputy Attorney General and Assistant Attorney General for DoJ's Office of Legislative Affairs. Prior to that, he served in a number of capacities on Capitol Hill, including as the Chief Legislative Counsel and Parliamentarian of the House Committee on the Judiciary.

Another option would be to enact a federal law pursuant to Congress' Commerce Clause jurisdiction prohibiting the shipment of goods in violation of the sales tax laws of the state to which the goods are shipped. This is very similar to what Congress did in the 1913 Webb-Kenyon Act concerning the regulation and taxation of intoxicating liquors. In 2000, Congress reaffirmed and strengthened Webb-Kenyon by enacting an enforcement provision giving states the ability to seek injunctive relief in federal court for violations of Webb-Kenyon, including the failure of remote sellers of intoxicating liquors to collect state sales and excise taxes.

The Webb-Kenyon model is simple: it authorizes no new taxes; it recognizes the sovereign nature of state taxing decisions; it would not allow discriminatory sales taxes; and it should be politically acceptable because the Webb-Kenyon enforcement amendments garnered the support of this Committee and 310 Aye votes in the House of Representatives on August 3, 1999.

A brief review of the Webb-Kenyon Act and related Commerce Clause jurisprudence regarding the regulation of intoxicating liquors demonstrates how this model could apply to remote Internet sales.

Brief History of the Webb-Kenyon Act

Today, most regulation of alcohol occurs at the state level; however, state regulation of alcohol has not always been the norm in the U.S.[2] The ability of states to regulate alcohol has change as the Supreme Court's Commerce Clause jurisprudence has developed over the years and as Congress has responded to those changes.[3] For example, in the mid-19th century, states were understood to enjoy broad authority to regulate alcohol based on a series of highly contested cases in which the Supreme Court held that, unless there was a federal statute to the contrary, states were not constrained from what we refer to today as dormant or negative commerce clause restrictions.[4]

The temperance movement successfully sought to curb the sale and distribution of alcoholic beverages one state at a time. However, by the 1880's and 1890's, the Supreme Court became less accepting of state laws targeting imports. During this time, the Supreme Court began to recognize the implied restrictions inherent in the Commerce Clause; i.e. the dormant Commerce Clause restrictions on state action that discriminate against out-of-state products.[5]

Furthermore, and more instructive to today's topic, the Court held that the Commerce Clause prevented states from passing facially neutral laws that placed an

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[2] A complete explanation of this fascinating history is recounted in *Granholm. v. Heald*, 544 U.S. 460, 476 - 485 (2005).

[3] *See Castlewood Int'l Corp. v. Simon*, 596 F.2d 638, 641 (5th Cir. 1979) ("Since the founding of our Republic, power over regulation of liquor has ebbed and flowed between the federal government and the states.")

[4] *The License Cases*, 46 U.S. (5 How.) 504, 579 (1947).

[5] *Walling v. Michigan*, 116 U.S. 446 (1886) (invalidating a Michigan tax that burdened only liquor imports).

impermissible burden on interstate commerce.[6] For example, the Supreme Court in *Bowman v. Chicago & Northwestern Rail Co.* invalidated an Iowa statute requiring all liquor importers to have a permit.[7] In *Leisy v. Hardin*,[8] the Supreme Court held that, notwithstanding the fact that the statute in question did not discriminate against out-of-state sellers, Iowa could not prevent the importation of beer "until it became comingled in the common mass of property within the State. Up to that point of time," the Court reasoned, "in the absence of congressional permission to do so, the State had no power to interfere by seizure, or any other action, in prohibition of importation and sale by the foreign or non-resident importer."[9]

Because the Commerce Clause pendulum had swung so far away from the doctrine annunciated in *The License Cases*, the temperance movement took its case to the U.S. Congress. To address *Bowman* and *Leisy*, Congress enacted the Wilson Act which empowered the states to regulate imported liquor "to the same extent and in the same manner as though such liquids or liquors had been produced in such State or Territory . . . ."[10]

The Wilson Act was challenged under a number of legal theories. In response to a Commerce Clause challenge, the Supreme Court avoided the constitutional issue by construing the Act narrowly, holding that the Act did not permit states to regulate alcoholic beverages shipped in interstate commerce for personal use,[11] which many viewed as a direct-shipment loophole.

In order to close this direct-shipment loophole, in 1913 Congress enacted the Webb-Kenyon Act[12] over President Taft's veto.[13] The Supreme Court held Webb-Kenyon to be constitutional and observed that the Act prevented "the immunity characteristic of interstate commerce from being used to permit the receipt of liquor through such commerce in States contrary to their laws, and thus in effect afford a means by subterfuge and indirection to set such laws at naught."[14]

In the same way that the Webb-Kenyon Act eliminated the regulatory advantage obtained through the "immunity characteristic" of the Commerce Clause, today this Committee and Congress are considering ways to eliminate the regulatory advantage

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[6] *Granholm* at 476-477 (citations omitted).
[7] 125 U.S. 465 (1888).
[8] 135 U.S. 100 (1890).
[9] *Id* at 124-125. It should be noted that "Bowman and its progeny rested in part on the since rejected original-package doctrine. Under this doctrine goods shipped in interstate commerce were immune from state regulation while in their original package." *Granholm* at 477.
[10] 27 U.S.C. § 121.
[11] *Rhodes v. Iowa*, 170 U.S. 412, 421 (1898).
[12] 27 U.S.C., §122.
[13] Interestingly, President Taft vetoed Webb-Kenyon based on Attorney General Wickersham advice that "any law authorizing the States to regulate direct shipments for personal use would be an unlawful delegation of Congress' Commerce Clause powers." *Granholm* at 481.
[14] *Clark Distilling Co. V. Western Maryland R. Co*, 242 U.S. 311, 324 (1917).

enjoyed by remote sellers under contemporary Commerce Clause jurisprudence to avoid adhering to state tax law.

Some may argue that the Webb-Kenyon model is an inapt solution to the collection of state sales taxes by remote sellers because alcohol is "different" due to the history of state regulation and because the 21st Amendment repealed the 18th Amendment (Prohibition) and vested in the states the ability to regulate alcohol.

As already demonstrated, however, alcohol has not always been regulated at the state level, and at times in our history, states could not even regulate alcohol "in its original packaging" because that was understood to mean that the alcohol was still in interstate commerce and not subject to state regulation, including taxation. A strong argument could be made that the only reason alcohol is treated differently is because a powerful political movement – the temperance movement – had great support in Congress and across the nation.

Second, it would be incorrect to argue that Section 2 of the Twenty-first Amendment, which authorizes states to regulate alcohol, sets alcohol apart from other goods. The Supreme Court has noted that § 2 of the Twenty-first amendment expresses "the framers' clear intention of constitutionalizing the Commerce Clause framework established under [the Wilson and Webb-Kenyon Acts]."[15] In other words, the goals of section 2 of the Twenty-first Amendment had already been achieved by Congress in enacting Webb-Kenyon. Webb-Kenyon was a valid exercise of Congress' Commerce Clause authority. Furthermore, contemporary § 2 cases have found that the Twenty-first Amendment will not save "state laws that violate other provisions of the constitution"; "§ 2 does not abrogate Congress' Commerce Clause powers with regard to liquor"; and "state regulation of alcohol is limited by the nondiscrimination principle of the Commerce Clause." [16] In sum, § 2 did not expand states' authority beyond that which they already enjoyed under Webb-Kenyon.[17] Congress can exercise the same authority with regard to all goods subject to state tax laws.[18]

Congress Reaffirms and Enhances Webb-Kenyon in 2000

In 2000, Congress enacted the Twenty-first Amendment Enforcement Act ("Enforcement Act"), which amended Webb-Kenyon to provide states a means of enforcement (injunctive relief) when a state attorney general "has reasonable cause to believe that a person is engaged in, or has engaged in, any act that would constitute a violation of a State law regulating the importation or transportation of any intoxicating

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[15] 429 U.S. 190, 205-206 (1976) (footnote omitted). *See also, Florida Depatment of Business Regulation v. Zachy's Wine & Liquors, Inc.*, 125 F.3d 1399, 1402 (1997) ("In addition to repealing prohibition, the Twenty-first Amendment in effect constitutionalizes the Webb-Kenyon Act.").

[16] *Granholm* at 486-487.

[17] Congress reenacted Webb-Kenyon in 1935 after the ratification of the 21st Amendment.

[18] *Quill Corp. v. North Dakota*, 504 U.S. 298, 318 (1992)

liquor. . . ."[19] Congress took this action because direct shipments of alcohol in contravention of state law was a growing problem. The House Committee on the Judiciary's report on the bill observed that "several new players have entered the alcoholic beverage industry" and noted that "[w]ith the advent of the Internet, they have been able to advertise their product nationally and have been able to widely expand their market access." [20] The Committee report makes clear that the absence of an enforcement mechanism will hamper states' "ability to police sales to underage purchasers."[21] Moreover, of concern to the Committee and to Congress was that direct shippers of alcohol were avoiding state sales and excise tax laws: "Illegal direct shipments also deprive the state of the excise and sales tax revenue that would otherwise be generated by a regulated sale."[22] In fact, one of the key cases cited by the Committee in its report justifying the need for the Enforcement Act involved the State of Florida's allegations that an out-of-state direct shipper had failed to pay "excise taxes, sales taxes, and license fees."[23] During a hearing on a similar bill in 1997, Members of the House Judiciary Committee heard testimony from the sponsors of the legislation,[24] state officials,[25] and industry supporters.[26] Among the reasons cited for supporting the Enforcement Act, were that direct sales over the Internet, through catalogues, and other means, circumvented state sales and excise taxes. In his opening statement, Chairman Coble summed up the concern: "In recent years, improved methods of shipment and the advent of the Internet have made it possible for small wineries and breweries to reach a much broader market." He noted that "[s]tates also claim that direct shipment of alcoholic beverages to consumers deprives a state of tax revenues . . . ."[27] When the Enforcement Act was

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[19] 27 U.S.C. § 122a.
[20] H. Rept. 106-265, 106th Cong., 1st. Sess. at 5 (July 27, 1999).
[21] *Ibid.*
[22] *Ibid.*
[23] *Florida Department of Business Regulation v. Zachy's Wine and Liquor, Inc.*, 125 F.3d 1399, 1400 (1997).
[24] Rep. Robert Ehrlich, the sponsor of the legislation, testified that "Illegal interstate shipping of alcohol not only violates a state's ability to regulate incoming alcohol beverages, it also bypasses state excise taxes. The companies that obey current law and ship alcohol beverages in accordance with existing state laws pay a significant amount of money in taxes. Illegal shippers deprive states of excise and state sales tax revenue which is generated from sales of alcohol beverages. The tax revenue lost to states due to illegal shipments is estimated between $200 and $600 million a year." Statement of Representative Bob Ehrlich, Hearing on Amendment to the Webb-Kenyon Act; and The Private Property Implementation Act of 1997, Subcommittee on Courts and Intellectual Property, 1st Sess., 105th Cong. (Sept. 25, 1997).
[25] James M. Goldberg, on behalf of the Joint Committee of States, complained: "Out-of-state sellers shipping illegally into a state deprive the state of the excise tax revenue which is generated from in-state sales of beer, wine and distilled spirits, not to mention the sales tax revenue which goes uncollected from an illegal interstate sale. Statement of James M. Goldberg, Hearing on Amendment to the Webb-Kenyon Act; and The Private Property Implementation Act of 1997, Subcommittee on Courts and Intellectual Property, 1st Sess., 105th Cong., at 45 (Sept. 25, 1997) (footnote omitted).
[26] Jim Simpson, on behalf of the National Licensed Beverage Association, complained that "NLBA members have become greatly alarmed at the increasing frequency of consumers being solicited to buy beverage alcohol directly through catalogs, magazines, direct mail and the Internet." He noted that, among other problems, "[d]irect sales, in most cases, avoid State excise and sales taxes . . . ." After providing estimates of the lost state tax revenue, Mr. Simpson concluded that "[t]his hemorrhage of tax revenue will only increase as mail order, telephone, and Internet sales become more popular." Statement of Mr. Jim Simpson, Hearing on Amendment to the Webb-Kenyon Act; and The Private Property Implementation Act of 1997, Subcommittee on Courts and Intellectual Property, 1st Sess., 105th Cong., at 33 (Sept. 25, 1997).
[27] *Id at 2 & 5.*

considered by the full House, debate on the floor reflected the interest in helping states enforce their state sales and excise taxes.[28] Indeed, the Chief Senate sponsor of the Enforcement Act, Senator Hatch, noted the lost tax revenue generated by the sale of liquor from out-of-state direct shippers.[29] The record could not be any clearer that one of the primary reasons justifying the enactment of the Enforcement Act was the inability of states to enforce their rights under Webb-Kenyon to collect states sales and excise taxes from out-of-state direct shippers. That conclusion is extremely similar to the facts that gave rise to the Marketplace Fairness Act. All the elements discussed in 2000 – Internet retailers, direct shipments, and failure to collect state taxes – are all at work here, creating an uneven playing field for retailers. That is why the Webb-Kenyon and the Enforcement Act are an applicable precedent upon which to build a solution.

Conclusion

Congress could pass a one sentence statute modeled after the 1913 Webb-Kenyon Act prohibiting the direct or remote shipment of goods in violation of the tax laws of the receiving state. And, using the Enforcement Act as a guide, Congress could add several more sentences outlining the application of injunctive relief. This would provide an effective alternative solution.

Mr. Chairman and Members of the Committee, we hope this idea helps generate thought and discussion about the best way forward to solve the critical disparate tax treatment of remote and in-state sales.

I look forward to your questions.

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[28] *See e.g.*, Statement of Rep. Delahunt, 145 Cong. Rec 112, H6858 (Aug. 3, 1999) ("The bill is necessary not only to prevent illegal shipments to minors, but to enable States to police licensing standards, track sale, and collect taxes on those sales. Last year, illegal alcohol shipments cost States some $600 million in lost revenues. State taxes on alcohol are an important source of support for State programs, and protecting that funding stream is a legitimate State objective."); Statement of Rep. Sensenbrenner, *Id* at H6860 ("These illegal direct shippers are bypassing State excise and sales taxes, operating without required licenses, and most appallingly, illegally selling alcohol to underage persons." Rep. Sensenbrenner emphasized that the Enforcement Act "does not change existing State laws, and makes no restrictions on legal Internet or catalog sales. It does not open the door to Internet taxation."); Statement of Rep. Barrett, Id. at H6865 (After noting that direct sales of alcohol "drain needed tax revenue," Rep. Barrett concluded that "companies in one State should not be able to disregard the laws of another State in an effort to reach new customers.

[29] Statement of Sen. Orrin Hatch, 145 Cong. Rec. 38, S2509 (March 10, 1999).

Mr. GOODLATTE. Thank you, Mr. Moschella.
Mr. Sutton, welcome.

TESTIMONY OF JAMES H. SUTTON, JR., CPA, ESQ., MOFFA, GAINOR, & SUTTON, PA

Mr. SUTTON. Thank you. I am here before you today to speak——
Mr. GOODLATTE. You may want to turn that microphone on and pull it close to you.
Mr. SUTTON. I am here before you today——
Mr. GOODLATTE. Pull it closer.
Mr. SUTTON. Is that on now?
Mr. GOODLATTE. That is it.
Mr. SUTTON. Okay. Thank you. I am here before you today to speak against my own personal interest. As a CPN attorney whose practice is devoted almost entirely to the State and local use tax controversy, if the Marketplace Fairness Act were to pass, my law practice would explode from clients all over the country. So when I say to you today that the Marketplace Fairness Act is a bad idea, it is because I truly believe it will cripple thousands of businesses and hurt our economy overall.

I handle tax audits, protests, litigation, collections, revocations, voluntary disclosures, and even criminal defense, all for sales tax every day. Each year my firm represents hundreds of people, business owners, who feel that they are not being treated fairly by the Florida Department of Revenue, just one State. I see firsthand how aggressive a State tax department can be and how time consuming and expensive it is for honest business owners to defend themselves.

Software solutions can make filing tax returns possible. But the complications for audits, collections, investigations, and criminal prosecutions will not be handled by the software.

In my written testimony starting on page 4 is a listing of sales tax horror stories and other issues registered voters in your State will be facing if the Marketplace Fairness Act passes. For example, are you ready to explain to the registered voters in your State how they face 100 years of potential jail time spread between 45 States because only a month or two of use tax was not reported when their business went under? Are you ready for citizens of your State to be extradited to Florida or to other States because that State perceives that a business owner in your State owes use tax? Are you ready for Florida and other States to completely ignore your State's corporate liability shell protection to impose personal liabilities of the business owners in your State? These are only some of the many problems that will ensue if the Marketplace Fairness Act passes.

The purpose of the commerce clause is to ensure commerce flows freely between the States without overly burdensome State regulation. The Marketplace Fairness Act would literally obliterate the purpose of the commerce clause. We need a solution to the State tax problem, but forcing remote sellers to collect tax gives the States jurisdiction over those remote sellers, which causes a whirlwind of problems I see every day in just one State.

Consider that every State with a sales tax and a use tax already has all the laws, the rules, and the procedures in place for use

taxes. The problem is no one has the information to enforce it. So the solution is simple: taxable remote sales information needs to be made available to the purchasers and the States.

I commend the great State of Colorado for trying something very similar to this idea. However, under the commerce clause, only the Federal Government has the authority to do this similar to the reporting that is being done in the EU for more than 10 years. Therefore, I propose a consumer private reporting, CPR system, in which a vendor would utilize the software that everybody else is proposing to use to accumulate information for 1099 style reporting to the purchasers and the States, but without the private information of what is actually purchased. A database will be created at the Federal level to accumulate that information to report. Self-reporting would become commonplace, and enforcement made easy for the States with no new State use tax laws needed.

Finally, the law should establish a simplified nexus rule for sales and tax use tax purposes. I believe consumer private reporting is your answer. It places the least amount of burden on interstate commerce. It compensates remote sellers for their time and expense. It allows the States the sovereign right to enforce their own use tax laws without impeding on the personal privacy of the purchaser.

Sales and tax reporting in this country needs Federal CPR. Thank you.

[The prepared statement of Mr. Sutton follows:]

Written Submission of

James H Sutton Jr, CPA, Esq.
Moffa, Gainor, & Sutton, P.A.

Hearing on

Exploring Alternatives on the Internet Sales Tax Issue

Before the Judiciary Committee

March 12, 2014

Consumer Private Reporting

Exploring Alternative Solutions on the Internet Sales Tax Issue
Testimony and Additional Materials from:
James H Sutton, Jr., CPA, Esq.
The Law Offices of Moffa, Gainor, & Sutton, PA

II. WRITTEN STATEMENT

Mr. Chairman, Mr. Ranking Member, and members of the Committee:

I appreciate the opportunity to submit this statement on alternatives to the remote sales and use tax problem that we are facing in this country. I applaud the efforts of this committee for taking the time to explore not only the alternatives to taxing internet-based transactions, but also all remote sales between states. The implications for this country are vastly complex. As a CPA and Attorney that does almost nothing but sales and use tax controversy, I hope to provide valuable insight into how your alternative solutions will impact remote sellers. I believe that this country needs the federal government to intervene to correct the sales and use tax problems we are facing.

a. Executive Summary

- I am here before you today because I am a Florida CPA and Attorney whose law practice is devoted almost entirely to sales and use tax controversy in a state with projected sales tax revenues of over $22 billion this fiscal year. I handle audits, protests, litigations, collections, revocations, and even criminal defense – all from a sales tax perspective. I'm not taking about a few of the Fortune 1,000 companies. Each year my firm represents hundreds of small, medium, and large businesses as well as individuals who all feel they are not being treated fairly by the Florida Department of Revenue. As a result, I see firsthand every single day how a state tax department can walk all over the rights of business owners. I could tell you hundreds of horror stories, but included herein are summaries of examples of (1) states ignoring taxpayer rights and (2) simple areas of statutory construction that leave small business owners helpless against the state taxing authority.
- Based on my experience and the many examples provided herein, I can tell you unequivocally that you do not want to give state tax departments free reign to regulate remote sellers throughout this country. It would be devastating to businesses both large and small. Perhaps software solutions can make filling tax returns possible, but the complications for audits, collections, investigations, and criminal prosecutions will not be handled by software and will threaten to cripple our interstate commerce economy.
- Both sales tax and use tax are excise taxes – a tax on the right to do something. Sales tax is on the right to sell (or in some states, buy) a good or service within the borders of a state. Use tax is a tax on the right to use that good or service in the state, if sales tax has not already been paid. There must either be a sale or a use in the borders of the state for either tax to apply. Therefore, a remote seller is subject to tax in the state of its customer. The remote seller is not doing anything that would subject it to tax in that remote state. Only the purchaser is engaging in a taxable event – exercising some type control over the problem in the state that is subject to use tax.
- There is something unfair happening to brick and mortar local businesses in this country, but it is not remote sellers hurting these local businesses. The pain is caused by the lack of use tax enforcement by the state tax departments on the state's own citizens. There is something unfair happening to the states, but it is not remote sellers hurting the states. Again, it is the inability of state tax departments to enforce use tax laws on the state's own citizens. The solution to both of these problems is clear. We need to figure out a way for the states to be able to enforce existing use tax laws. The amazing thing is that each and every state with a sales tax already has every

law, every rule, the tax form, collection procedure, and well tested case law in place to enforce their own use tax laws. They only thing missing is the remote sales information.

- I am proposing that the sales and use tax system is not working and it needs CPR- federal Consumer Private Reporting legislation that will require remote sellers to provide sales information to the states and to purchasers so self-reporting of use taxes can become common place in this country. The reporting would be done on an aggregate basis through a federal database so the private information of what consumers purchased stays between the purchaser and the remote seller. The remote vendors could either use state-funded software to report the sales or they could use their own software to provide the sales information. The details of the Consumer Private Reporting system and alternative means of implementing it are provided herein. The proposal meets all 7 of the Goodlatte Principles, without placing extreme burdens on remote sellers and the national economy. It also resembles a reporting system being used in the EU.
- Colorado should be commended for attempting a similar statute. However, under the commerce clause, no state has the power to force remote sellers to report. Only the federal government has this authority. The C.P.R. system is similar to the reporting done in the European Union for more than a decade.
- Finally, any federal legislation must simplify the nexus rules for sales and use tax in this country, with a codification of the *Quill*[1] "physical presence" standard. Failure to do so will result in the state continuing their expansive laws that continually ignore the Supreme Court's ruling in *Quill*. The U.S. Supreme Court has abstained from taking a single sales and use tax nexus case for over 20 years, after urging Congress to address the nexus issue. Now is the time to do so and create simplified certainty for interstate commerce with regard to sales tax nexus.

b. Examples of Sales and Use Tax Creating Hardships for Businesses

Below are examples of how sales and use tax statutes, rules, and state tax department procedures are all weighted against vendors. For the most part, these examples just take into consideration the complexities of one state's laws. Imagine the variety of complexities that would result in 45 state's laws applying to a remote vendor. As you consider these stories, please also realize that these are but a drop in a sea of turmoil happening right now to small business owners in this country who don't have a high powered lobbyist to fight for them. These business owners rely on you to protect them. If you pass federal legislation that gives states the right to reach across state lines, this turmoil will be unleashed on business owners all over the country. So I ask you to remember that by creating the commerce clause - the founders of this country trusted you, members of Congress, to stop the states from putting their own revenue needs ahead of the good of this country and the free flow of commerce among the states.

Arrested for Sale Tax: Would it surprise you to learn that in Florida it only takes $301 of unremitted sales tax over a 5 year period to become 3rd degree felony punishable by up to 5 years in jail and $5,000 in fines? If the tax due crosses $20,000, it is punishable by up to 15 years in jail. Struggling business owners are shocked to find out that the Florida Department of Revenue has an investigation unit whose job is to see the business owner arrested because they paid employees instead of the state.

100+ Years in Jail for a Failed Business Owing Sales Tax: According to the Small Business Administration, 30% of businesses fail after two years and 50% of businesses fail after five years.[2] Most businesses go under owing money and, in my experience a shocking number of

[1] *Quill vs. North Dakota*, 504 U.S. 298 (1992) (physical presence required for nexus).
[2] SBA Office of Advocacy, Frequently Asked Questions, Updated January 2011 (http://www.sba.gov/sites/default/files/sbfaq.pdf)

them will have two or three months of collected, but not remitted, sales tax. If a statute like the MFA passes, then 50% of new companies collecting sales tax on behalf of 45 states will fail, many owing sales tax to 45 states. If the average minimum criminal sales/use tax fraud statute in this country is the length of Florida's, 5 years for $301 of tax, then a failed business owner (and all responsible parties in the business) could be facing up to 225 years in prison (5 years times 45 states with a sales/use tax). ***This is one of a hundred unintended consequences of the Marketplace Fairness Act.***

Extradition: I know an 80+ year old woman who was taking care of a terminally ill family member in Illinois when the police came to arrested her. This poor woman, whose restaurant was believed to owe sales tax when it closed, spent 4 days in a van with 10 others, chained to her seat, with no sleep, no showers, no heat, and $1 sandwiches and a cup of water for breakfast, lunch, and dinner. ***Do you want Florida extraditing your citizens for perceived sales tax problems?***

Debtor's Prison: If a business owes sales tax and simply cannot afford to pay the tax, then the owner faces serious prison terms under Florida's sales tax fraud statutes. However, if the business owner can pay the tax back, invariably, the business owner can avoid jail time. ***How are you going to explain to citizens in your district the fact that they are going to jail for sales tax debt they can not a not a debtors prison constitutional violation?***

Guilty until Proven Innocent: I know just how overwhelming it is for a business owner to find out that Florida has the power to estimate sales taxes with the presumption of accuracy, placing the burden on the business to prove the state wrong. What is worse is that Florida often estimates twice the historical average of tax due, and then the taxpayer owes that amount if the taxpayer does not have the proper paperwork or the help of a good professional help prove the state wrong. This is effective a guilty until proven innocent statute akin to legalized extortion. ***Do you want Florida's tactics unleashed on business owners of your state?***

Automated Collection Process: The states are moving towards automated collections, taking the human element out of the collection process. Automated bank freezes, robotic calls harassing for late return, and tax liens filed with no human intervention. This is when mistakes happen – such as the tax warrant apparently being issued against the Florida Supreme Court in February 2012.[3] ***What are you going to tell registered voters in your district when they complain to you that remote state tax departments are freezing their business's bank account over mistakes made by automated computer systems?***

200% of Tax Personal Liability - Piercing the Corporate Veil: Many states have very nasty statutes that allow the state to completely ignore corporate shell liability protection to come after the officers, directors, and shareholders for sales tax liability. Florida has a 200% of tax penalty on each responsible party that gets used regularly or agent business owners whose failing business may have owned sales and/or use tax.[4] ***Are you ready to explain to your state's business owners how you allowed them to become personally liable for use tax that their business may have owed other states?***

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[3] Florida Tax Warrant # 1000000250554, Issued February 9, 2012 in Leon County, Florida. (It turned out the warrant was intended to be filed on the Florida Supreme Court Historical Society, but the computer system truncated the name. The Florida Supreme Court Historical Society gives tours of the Florida Supreme Court and the board of Directors are all former presidents of the Florida Bar).

[4] *See*, Sec. 213.29, Fla. Stat.

Wavier of Rights for Payment Plan: In Florida, a taxpayer has the statutory right to be considered for a payment plan under the Taxpayer Bill of Rights.[5] However, the Florida Department of Revenue decided that taxpayers should be required to give up all appeal rights and personally guarantee not only the past tax liability but also the next 12 months of future liabilities – just to enter a payment plan that they have the right to under the law. ***If a business owner in your district gets behind in remitting use tax, which many will, then can you imagine them entering personal guarantees with 45 states?***

Auditors Not Trained on Taxpayer Rights[6]: I have personally been through Florida's certified sales tax auditor training – and there was no training on the Florida Taxpayer Bill of Rights. I have asked many current and former Florida sales and use tax auditors if they were trained in the Taxpayer Bill of Rights. Would you believe that I have been consistently told that the Department of Revenue does not even bother to teach auditors about the Florida Taxpayer Bill of Rights? ***Perhaps your state revenue department respects taxpayer rights, but under the Marketplace Fairness Act, business owners in your state will be subject to the rules, regulations, and enforcement actions of 45 states and will not be able to avail themselves of the taxpayer rights in your state when dealing with other states.***

Sales Tax Audits Take 6 to 12 Months: The typical sales tax audit takes between 6 and 12 months to complete (presuming an administrative challenge is not necessary). If federal legislation allows remote sellers to have nexus everywhere, then the "free" software will not manage these audits. The remote seller will have to bear the time and expense to manage approximately 8 audits[7] a year and be liable for the mistakes. ***Do you want to explain to business owners in your state why they have to bear the cost of possibly eight sales tax audits a year?***

Appeal Rights Lost Before Even Getting the Notice: A taxpayer has a limited time frames a taxpayer has to respond or challenge a position of any state tax department. Sometimes that time frame is as short as 20 days in Florida. The date is determined based on the date on the letter giving the notice. However, the Florida Department of Revenue will wait days to mail the letter, sometimes up to a week. Considering that the letter might also take several days to arrive at the taxpayer's location then the taxpayer has almost no time to respond and loses their appeal rights. ***Letters with taxpayer deadlines to respond sent across the country could easily miss deadlines and forfeit appeal rights, which would be a common place if the Marketplace Fairness Act is enacted.***

Pay to Play: Many states will not let a taxpayer challenge the state taxing authority in court unless the taxpayer has paid the tax in full. Small business with limited capital resources could be at a complete disadvantage when dealing with remote states – and have no representation in the state legislature to seek relief.

Contract Auditors: If you have been given the impression that states will not audit remote sellers very often under the Marketplace Fairness Act, then you are not aware of "contract auditors." Many states contact with third parties to perform sales tax audits. The states may not have enough state auditors to audit in 45 states, but you can guarantee that if it is profitable for the state, they will hire an endless supply of contact auditors to perform sales and use tax audits everywhere, including your state.

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[5] *See*, Sec. 213.015(10), Fla. Stat.

[6] *See*, Sec. 213.015, Fla. Stat., also known as the Florida Taxpayer Bill of Rights.

[7] If a company is audited on average every 5 years by 45 states, then the company will be a little over 8 audits a year on average.

Lack of Uniformity of Enforcement: Florida, similar to most states, gives taxpayers "the right to fair and consistent application of the tax laws."[8] In all too many circumstances, local Revenue offices have completely different procedures and rules. For example, one local office will not enter any installment agreements for a period more than 6 months. The remaining revenue offices will offer 12 month installment agreements. So taxpayers that have to request installment agreements in that one local revenue office are treated differently than the taxpayers elsewhere in the state. ***If state tax departments cannot treat their own residents uniformly, do you really expect remote state tax departments to treat your residents and local businesses with the same fairness as they treat their own in-state companies?***

Revenue Agents Ignore Tax Professionals: At almost all local levels of the Florida Department of Revenue, there are agents that believe that they can talk to the taxpayer anytime they want, even if the taxpayer has a power of attorney representing them. This is a clear violation of Florida's Taxpayer Bill of Rights.[9] This happens in audits, collections, and criminal investigations, the latter of which has US constitutional issues. The DOR added a line to the power of attorney trying to say that they don't have to contact the taxpayer's representative at all times if it is inconvenient. ***Do you want to explain to the tax professionals in your state why you voted for the Marketplace Fairness Act and allowed your in-state tax professionals to be completely ignored by out of state taxing authorities?***

Waive 5th Amendment Rights Just to Pay Tax: One of my "favorite" stories involves a business owner who came into a local revenue office to pay late taxes. The local collection agent refused to accept the payment unless the taxpayer signed a sworn statement that he was committing sales tax fraud for not paying on time. When the taxpayer refused, the collections agent escorted the taxpayer to a window with no windows where the collection agent and his supervisor berated the taxpayer with claims that he had to sign what amounted to a criminal confession. Neither the procedure by the local collection agents nor the form the taxpayer was asked to sign was approved by the Florida Department of Revenue, both of which are considered illegal, unpromulgated procedures under Florida law.

Unlawful Threats of Embarrassment, Arrest, and Closing Business: Collection agents have been known to greatly exceed any authority granted under Florida law to harass taxpayers because the collect agent gets fed up with or upset with the taxpayer. For example, a law suit against the Florida Department of Revenue in February 2014, seeking emergency and temporary injunctive relief to stop a Florida Department of Revenue agent from harassing the business owner.[10] The suit was filed alleging a local revenue agent was belligerent, aggressive, strong-armed, and vindictive, threating to embarrass the taxpayer in front of all his customers, lock his doors, close down his business, and have him arrested. A collection agent does not have the authority to do any of these things. It takes a full revocation proceeding, with due process rights and hearings, to close down a business for sales tax in Florida. Only a state attorney, not a collection agent, can file criminal charges against an individual for sales tax fraud, and only after an investigation. ***Imagine what collection agents from Florida would do to remote sellers located in your state if a statute like the Marketplace Fairness Act is passed.***

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[8] Sec. 213.015(21), Fla Stat. ("The right to fair and consistent application of the tax laws of this state by the Department of Revenue").

[9] Sec. 213.015(3), Fla. Stat. ("The right to be represented or advised by counsel or other qualified representatives at any time in administrative interactions with the department ... ").

[10] *Royal Trade Investments of Sarasota, Inc. v. State of Florida Department of Revenue*, (Case No. 2014 CA 001082 NC, 12th Cir. Ct. Fla.) complaint filed February 21, 2014.

Every one of the issues listed above will be avoided if remote sellers are merely required to report sales, instead of becoming use tax collection agents for the states. This is why I believe that Consumer Private Reporting legislation – modified to completely protect consumers privacy - is the most simple and cost effective solution, while not overburdening remote sellers or our national economy.

c. The Basics of Sales Tax vs Use Tax That Few People Understand

Most people do not fully understand the sales and use tax issues for remote transactions. Both sales tax and use tax are excise taxes – a tax on the right to do something. Sales tax is on the right to sell (or in some states, buy) a good or service within the borders of a state. In-state vendors charge sales tax, because under most state laws, it is a tax on their right to sell. Yes, they have to pass the tax on to their customers – but the taxable activity is the business selling. This is why brick and mortar companies collect sales tax.

Use tax is a tax on the right to use that good or service in the state, if sales tax has not already been paid. Use tax is not the obligation of an out of state seller because they have not done a taxable activity in the destination state. Selling something in Georgia to someone in Florida simply is not a taxable event for Florida. There is no legal mechanism in place to tax the Georgia seller for sales tax or use tax purposes in Florida (as long as the Georgia company does not have nexus with Florida). The taxable event in Florida is the purchaser using the good or service in Florida. Now Florida would love to force the Georgia seller to act as a collection agent for Florida's use tax that the purchaser owes. But the Georgia seller literally has not done anything that would subject the Georgia seller to tax.

This is a very real distinction that almost no one outside the full time state and local tax (SALT) profession knows. It is why the remote seller is not getting away with anything. They simply are not doing a taxable activity.

The in state brick and mortar company is disadvantaged not because remote sellers are not collecting use tax. Instead, it is because their own state tax department is not enforcing their use tax laws on people purchasing goods remotely. The state is disadvantaged not because remote sellers are not collecting use tax. Instead, it is because the state tax department does not have an easy means of obtaining the information on remote purchases subject to use tax in the state.

d. CONSUMER PRIVATE REPORTING

COMPLIES WITH ALL SEVEN GOODLATTE PRINCIPLES FOR TAXING REMOTE SALES WHILE PROTECTING CONSUMER'S PRIVACY

The biggest concern with any proposed legislation aimed at reporting remote sales to the purchaser's state is that doing so would be a violation of the consumer's right to privacy.[11] There is a simple way to alleviate the privacy concerns with a modified consumer reporting system that protects the purchaser's privacy – and does so in a way that burdens the free flow of interstate commerce in the least way possible.

The Basics of a Consumer Private Reporting System

- Federally require remote seller to report remote sales. The reporting would either be done by the company itself (if approved to do so) or through approved software vendors that specialize in helping sellers determine which goods are taxable in which states. The specifics of what exactly is purchased never leaves the remote vendor's system, so the purchaser's private information stays between the vendor and the purchaser.
- Approved software vendors (or companies that self-report) would then report to a newly created federal database that would combine sales information in a 1099 style format for each state and each purchaser.
- The purchasers would then have the information to file their own use tax returns with the state and remit the use tax that has always been due. Because the purchaser knows the state has the information, filing use tax returns will be encouraged.
- If a purchaser does not file a use tax return, then every state that has a sales tax already has a process in place to send a friendly letter to the resident purchaser reminding them to pay the use tax. Each state could choose to be strict or lax about the use tax compliance, but the people being taxed would have a vote on the government officials representing them.
- The purchaser would have the right to reveal the specifics of a purchase to the state to prove that an item should not be taxed. Otherwise, the state would not have the specifics of what was purchased.

Additional Details of the Consumer Private Reporting System

- Set federal standards for the minimum information and a standard format[12] of that information that needs to be provided to the software vendors and to the federal database. This will allow standardization for the whole industry.
- Approved software vendors will be funded by the states, not the remote vendors, potentially based on a percentage of (taxable and exempt) sales reported through the system (by state). Companies that are approved to self-report into the federal database would also be reimbursed for the cost of implementation.
- States would have the right to audit the software companies for compliance with the individual state's laws.

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[11] It should be noted that if a taxing authority has jurisdiction over a vendor, remote or otherwise, then the notion of consumer privacy is a complete fiction. A state tax auditor has the right to inspect each and every customer purchase record during a sales and use tax audit – regardless of whether the information is reported to the state. So, the proposed Marketplace Fairness Act (and any similar collecting and remitting legislation) would give the states the authority to review every single purchase record during an audit of an out of state vendor.

[12] The format should be ubiquitous and scalable, so it can be used everyone and installed on one machine or 300 different types of hardware.

- For approved remote vendors that choose to self-report into the federal database, the states would have the right to review the remote vendor's tax coding process for good faith compliance. The remote sellers would not be liable for mistakes in taxability coding, but substantial non-compliance based on a reasonable standard could result in the remote seller being required to use an approved third party software vendor for tax determination and reporting.
- If a vendor elects to use an approved third party software provider, remote vendors could apply for reimbursement of expenses to upgrade software to account for the new reporting system during the first year – to be funded by the states.
- If a remote seller has nexus with a state, then normal sales/use tax collection rules would apply.
- If a remote seller is discovered to have nexus, then the remote seller would be pardoned for all periods reported to the states through the new federal system, but then normal sales and use tax rules would apply.
- The federal law would create a bright line nexus standard at the federal level for sales and use tax purposes similar to the rules established in Quill vs. North Dakota, 504 U.S. 298 (1992) (physical presence required). If use taxes are being collected via self-reporting, then the state will not have a need to push for nexus of remote sellers. Create a bright line test at the federal level to create certainty for businesses.
- Purchaser's information would be accumulated based on several sources: federal tax identification number, credit card number, and/or, if opted by the purchaser, a completely separate US sales tax identification number issued by the authority overseeing this process.

Controversial Possible Additions/Alternatives

- A small seller exemption could be part of the legislation, such that businesses with a minimum number of remote sales or a minimum dollar of remote sales would be exempt. Otherwise, the expense to occasional sellers and low dollar volume sellers would be too high and would keep these businesses from engaging in interstate commerce. For example, if a brick and mortar company ships a good to an out of state customer, then that would be a remote sale. For illustration purposes, an exemption might be available for a brick and mortar company that only does 50 or less of these a year or less than $100,000 a year. The same exemption, whatever it was determined to be, would apply to all remote sellers. If the sales tax rate across the country is 6%, then the unreported remote sales could result in $6,000 of use tax going unreported to all 45 states ($133 per state). The threshold for the exemption could be set at the estimated cost (time/labor) to implement the system versus the average unreported use tax potentially lost related to those sales.
- Instead of tasking remote sellers to determine taxability of remote sales state by state, have the remote sellers simply report gross remote sales by person, by state. The process would still need some type of federal database for accumulating the information so that the states do not receive any details on what was purchased. The federal database would issue a 1099 style report to the state and the purchaser so self-reporting of use tax would be easy and commonplace. To account for a portion of the sales that would be exempt under state law, each consumer would be allowed to elect a certain percentage be exempt. If the purchaser wanted to claim more exemptions, then the purchaser has the right to prove a higher exemption level. Each state could set their own exemption percentage to account for the typical exemptions available in that state. Remote sellers would be subject to the federal reporting requirements, not the remote state's jurisdiction.

e. BENEFITS OF A CONSUMER PRIVATE REPORTING SYSTEM

States Collect Use Taxes: Consumer Private Reporting legislation would allow the states to finally enforce the use tax laws that have been in force for decades, and mostly through a means of consumer self-reporting. Even in states, such as Florida, with no personal income tax return – accountants and CPA's would incorporate use tax return filing with their normal federal income tax return services. With the 1099 style reporting information readily available to purchasers – the returns would be very simple for taxpayers to fill out on their own. For the few purchasers who don't report, all states already have a letter audit process in place to notify their citizens of the use tax obligation. The states would collect billions of dollars of use tax revenue through a self-reporting under a Consumer Private Reporting system.

Brick and mortar vs Remote Seller – Take Sales and Use Tax Out of the Equation: Consumer Private Reporting Legislation would make every purchase subject to sales and use tax regardless of whether from a remote seller or a brick-and-mortar retailer. Both remote sellers and brick and mortar retailers would be required to comply with the sales and use tax laws of their state of domicile and anywhere that they have nexus. Remote sellers would have a small additional burden of utilizing the reporting software for remote sales. However, this small burden on remote sellers is nothing compared to keeping up with the sales tax laws in 45 states and 9,600+ local sales tax jurisdictions as well as going through sales and use tax audits for 45 states. Even if the remote vendor is only audited by the states every 5 years, that would still be an average of 8 sales and use tax audits a year, each of which can last anywhere from a few months to a couple of years. A Consumer Private Reporting system would remove these extreme burdens on remote sellers, allowing both the remote seller and the brick and mortar retailer to only have to deal with sales tax compliance/audit burdens in their nexus states – a true level playing field.

Purchaser Private Information Is Protect: If someone purchases a good or service from a remote seller, then that person is trusting that vendor with their private information. Under a Consumer Private Reporting system, the individual's private information stays between the customer and the vendor. All that gets reported to the state is the fact the instate customer purchased $x amount of taxable goods/service per month from all remote vendors. No additional information is reported to the state UNLESS the in-state purchaser wishes to disclose information to show that certain purchases were somehow exempt or otherwise not taxable. In fact, a remote purchase will protect customer private information more than an in state purchase – but a state tax auditor would have the right to review all customer purchase records on an in-state retailer. However, that will not be the case for remote purchases under a Consumer Private Reporting system.

Simplification of Sales and Use Tax State Laws In This Country: Consumer Private Reporting legislation would not turn state sales and use tax laws and 80+ years of case law precedent on its head. The realm of state and local taxation is complicated enough as it is. Instead the proposed legislation would simply make one small extension of federal law to require reporting of remote sellers through approved software vendors then use the existing use tax laws with every state that does not have a sales tax. As noted in footnote 2 above, the legislation might also be the perfect place to simplify the sales tax nexus rules, such as codifying the Quill decision.[13] If a state is already collecting the tax through an effective self-reporting system, then the state will have much less incentive to chase after remote sellers for sales tax collection responsibilities. The legislation could also provide some type of limited indemnity for a remote vendor if it is later discovered to have nexus[14] but only if that vendor can show that it was properly reporting sales through the Consumer Private Reporting system. Similarly, the legislation could allow a statute of limitations for remote sellers found to have nexus, but only if that vendor was already properly reporting sales.

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[13] Quill Corp. v. North Dakota, 504 U.S. 298 (1992) (requiring physical presence in state before the state can force use tax collection requirements on a remote seller).

[14] Such as an employee moves into another state, without the remote vendor realizing the sales tax nexus implications.

f. REVIEW OF GOODLATTE PRINCIPLES OF TAXING REMOTE SALES UNDER PRVATE CONSUMER REPORTING LEGISLATION

1. Tax Relief – Using the Internet should not create new or discriminatory taxes not faced in the offline world. Nor should any fresh precedent be created for other areas of interstate taxation by States.	A Consumer Private Reporting (CPR) statute would not create any new tax, but would merely allow the states to enforce their existing use tax laws.. Remote sales would be subject to the same use tax rate as the sales tax rate for purchasing the same good or service from an in-state retailer. The same previous nexus laws would still apply, but perhaps with statute of limitations and relief for vendors who were already reporting through the CPR system.
2. Tech Neutrality – Brick & Mortar, Exclusively Online, and Brick & Click businesses should all be on equal footing. The sales tax compliance burden on online Internet sellers should not be less, but neither should it be greater than that on similarly situated offline businesses.	A Consumer Private Reporting statute would allow both Brick and mortar retailers as well as remote sellers to focus on the sales and use tax rules and compliance burdens in their state of domicile. Remote sellers – online and otherwise – would have a small extra task of utilizing the approved software to report purchases to the software provider. However, the remote sellers will not have to collect and remit sales and use tax to 45 states. The burden is really placed on the software provider to make sure their software properly accounts for taxability of the sales and properly reports that information, without private consumer information, to the states.
3. No Regulation Without Representation – Those who would bear state taxation, regulation and compliance burdens should have direct recourse to protest unfair, unwise or discriminatory rates and enforcement.	Under Consumer Private Reporting legislation remote sellers would only be subject to the federal reporting law in the state for which they will have a vote in the state senators, representatives, and president. Businesses that collect/remit sales tax on in state sales and citizens that pay use tax on remote sales – would be subject to laws of their domicile state, for which they have a vote in their state government.[15] Businesses will not be forced to collect and remit for distant states without a legislative voice. State citizens will not be forced (directly or indirectly) to pay sales or use tax to distant states just because the vendor happens to be located in that state.
4. Simplicity – Governments should not stifle businesses by shifting onerous compliance requirements onto them; laws should be so simple and compliance so inexpensive and reliable as to render a small business exemption unnecessary.	Under a Consumer Private Reporting system, once the taxability of a remote seller's particular goods and services are determined, tracking and reporting sales to the software vendors would be literally effort-free. Software providers would be tasked with helping vendors determine what is and what is not taxable. Companies like Ebay and Amazon could have the remote vendor software provided to them by the states and integrated seamlessly into the on-line sales process. Remote vendors would not be required to

[15] Note: There will be circumstances, just as there are now, in which a purchaser will receive a good or service in a state other than their domicile and be taxed in that state with no vote in that state's government. The same could be true of businesses that operate in multiple states, but have no owners or employees that are domiciled in more than the home state of the company. This situation is limited to rare exception in both the current situation and under the proposed legislation.

	collect and maintain exemption certificate information -- as long as the sales information is provided through the CPR software. Also worth noting is the simplicity for purchasers to use a simple tax report to complete a simple use tax return – or place the taxable purchase amount and tax due on their personal state income tax return, such as California. This system is by far the simplest of legislative proposals on remote vendors. If the alternative gross reporting system is considered, then even determining taxability is not necessary.
5. Tax Competition – Governments should be encouraged to compete with one another to keep tax rates low and American businesses should not be disadvantaged vis-a-vis their foreign competitors.	Under a Consumer Private Reporting system, the inclusion of hundreds of millions of dollars of extra use tax revenue should make lowering sales tax rates feasible. More and more we hear of citizens choosing to move from high tax states to lower tax states. States that want to increase the number of residents, potential employees, potential business creators, and individual tax payers should feel even more encouraged to consider lowering their state sales tax rate. It is also worth noting that the choice of local for a remote seller is not a tax neutral decision because their customers will be paying sales tax in their state.
6. States' Rights -- States should be sovereign within their physical boundaries. In addition, the federal government should not mandate that States impose any sales tax compliance burdens.	Under a Consumer Private Reporting system, the states will be empowered with the information to enforce their own use tax laws and will not be mandated in any way to impose any sales tax compliance burdens. The states can even choose not to impose any use taxes on its citizens and businesses. Under a CPR system, state sovereignty over the state's own citizens and business is of the utmost importance. However, the states will not be granted sales tax jurisdiction over businesses domiciled in other sovereign states unless the company is deemed to have nexus in that state.
7. Privacy Rights -- Sensitive customer data must be protected.	Under a Consumer Private Reporting system, customer sensitive data would stay between the remote seller and the customer. If the remote seller uses a third party like EBay or Amazon to consummate the transaction, then the customer information would stay between the customer, the remote seller and the third party facilitator, just as it does under the current situation. The states will only receive a cumulative report from the software company that provides customer information for all taxable remote purchases from all remote vendors during the specified time from. The name of the vendors would even be withheld – by the software provider. Only the customer would have the right to disclose private transaction details if the customer wanted to challenge the taxability of a transaction or provide evidence of an exemption under state law.
8. Simply Sales and Use Tax Nexus – Any federal legislation in this area should simplify the nexus standard to add clarity to interstate commerce.	The proposed CPR statute will establish a Quill "physical presence" standard and meet the nexus simplification principle.

g. Summary of Consumer Private Reporting

The explosion of interstate commerce of the second half of the last century created some truly difficult problems in our state sales and use tax legal system. From carpet baggers to mail order catalog companies, everyone felt the strain of uncertainty – including our court system with over 300 full dress court opinions dealing with the Commerce Clause by 1959. The explosion of electronic commerce exponentially deteriorated the condition of the U.S. sales and use tax system. There is a growing injustice to brick and mortar vendors that operate purely inside a state's borders because their own state tax department cannot or will not enforce the state's use tax laws. There are also billions of dollars of use tax going unreported and uncollected by the states, because the states do not have the information to enforce the use tax laws on their own citizens. The Marketplace Fairness Act, which generally requires remote sellers to collect and remit use tax for the states, seems to solve the issues for brick and mortar vendors and the states, but does so in a way that allows 45 states to have extreme power over remote vendors everywhere. The compliance burdens alone are crippling for remote vendors, even with federally funded software to assist. Combine this with all the additional audit, collection, and criminal issues – by 45 different states – that remote vendors would face under the Marketplace Fairness Act, and the eventual burden on interstate commerce is truly impossible to even fathom.

The sales and use tax system in this country is struggling and it needs help. Only the federal government has the power to legislate in a way that can assist, but it must do so in a way that interferes with interstate commerce the least. I propose the Consumer Private Reporting system is that solution. It takes sales and use tax out of the competitive equation between brick and mortar vendors and remote sellers. It also allows the state to realize the dream of regular and systematic use tax reporting by its own citizens. However, the proposed Consumer Private Reporting legislation does so in a way that places the least amount of burden on remote sellers and interstate commerce, which is the ultimate purpose of the commerce clause in the first place.

In my humble opinion, the US Sales and Use Tax system is sick and needs Federal C.P.R.

h. CONCERNS OVER OTHER IDEAS

SSUTA: The SSUTA agreement is very well intended. However, sales taxes are simply too diverse among the states and quite often too complicated in even one state. The horror stories I have described herein are taxpayers dealing with only the sales and use tax laws of their own state. The SSUTA tends to deal with issues faced by bigger companies and does not address really address the needs of the small business. Nor does it comprehend the collection issues or criminal aspects of sales tax. It fails to address intrastate transactions, so we would effectively have two sets of rules for multistate versus in-state transactions. Although a good concept in theory, the prevalence of the internet has given rise for a need for federal legislation to assist in achieving a common solution among all the states.

Multistate Compact – Collect and Redistribute: This is one of the more interesting of the non-consumer reporting proposals. My biggest concern is that it would create a "tax wagging the dog" situation. Remote selling businesses would migrate to states that did not tax their good or service. A state that exempts clothing would become the hub for clothing remote sellers. Companies that sell food remotely would all locate their companies to states that exempt food. There is a fundamental problem when a sales tax law encourages businesses to treat this country like a checker board. Worse yet – in state retailers that sell those particular goods or services would be at a permanent disadvantage on sales tax because the in state retailer would still have to charge sales tax. This violates one of Goodlatte's Seven Principles of for Taxing Remote Sales. The states with no sales tax create a myriad additional problems. Within a few years – we would have much the same problems with do now, because of the ease of planning to achieve for 100% tax avoidance.

Grant States the Power to Exclude Instead of the Power to Tax: [*Forgive me for sounding like a law professor on this topic.*] While I believe that the Commerce Clause would allow Congress the power to grant the states the right to exclude interstate transactions, I believe doing so would be fundamentally against what the Commerce Clause was intended to do in the first place. The Commerce Clause is in place to ensure the free flow of commerce between the states. Prior to the Constitution, we had the Articles of Confederation. One of the biggest problems with the Articles of Confederation was that it did nothing to stop states from indirectly taxing each other through transactions flowing through their states. For example, the sea port states would heavily tax goods arriving from the sea for destinations in non-sea port states. The founders of our country created the Commerce Clause specifically to prevent tax hungry states from putting their individual state needs ahead of the good of the country. In doing so, the founders of this country trusted you, members of Congress, to put the free flow of commerce among the states above the need of the individual states. Therefore, in my humble opinion, this proposal violates the fundamental purpose of the commerce clause.

Origin Base Collection: The origin based tax system is the most theoretically interesting suggestion on the table. In theory, it is amazing. However, the devil is in the details and unfortunately the details reveal that an origin based system would create many of the same major problems we have today. (1) Any origin based system would encourage remote sellers to migrate into states with no sales tax, completely avoiding sales tax on all sales to anywhere in the country. I could foresee Montana, with no sales tax, being renamed Amazontana. In other words, this does not fix the dilemma of Brick/Mortar companies having to charge sales tax versus on-line transactions (violating one of the Goodlatte Principles). Furthermore, any federal sales and use tax law should encourage businesses to treat this country like a checkerboard – hoping from state to state just to avoid getting captured by a state tax. The law should be tax neutral at the business level, in my humble opinion. (2) I do not believe the commerce clause gives the federal government the ability to regulate a purely in-state activity. Therefore, even in an origin based system, the destination state would still have the sovereign right to tax the purely in-state use of the property – i.e. a use tax. This could result in sales tax in the origin state and use tax in the destination state. I could predict the courts getting involved to require the destination state to provide a credit to the

purchaser for sales tax paid at the origin state. However, the use tax problem would still exist in high tax states even if a credit is allowed for sales tax. (4) A federal required origin base sales/use tax system would encourage rampant state tax lobbying so certain products produced in the seller's state would be exempt from sales tax, exasperating the use tax problem in issue 2 above. (3) History tells us that states can be just as creative in ways to increase taxes as taxpayers are in avoiding taxes.[16] The federal government would have no authority to stop a state from slightly changing the nature of their in state tax on in state property so a credit for sales tax paid to another state would not be available.

[15] There are a number of states that switches to a modified gross receipts tax to avoid the state income tax jurisdictional limits of Public Law 86-272.

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AAA-CPA AMERICAN ASSOCIATION OF ATTORNEY-CERTIFIED PUBLIC ACCOUNTANTS

Members of Congress

RE: AAA-CPA Position on Marketplace Fairness Act

To Whom it May Concern:

The question before Congress is how to balance the injustice of the loss of sales and use tax revenue to the states and the competitive disadvantage to brick and mortar companies against the need to place the least restrictive burdens on the new and amazing commercial market place. The membership of the AAA-CPA believe that while the Marketplace Fairness Act addresses the concerns of the states' loss of use tax revenue and the competitive disadvantage thrust upon brick and mortar companies, the Act does so in a way that will place crippling burdens on interstate commerce, especially on the new electronic commercial marketplace. While the media tends to focus on billion dollar companies like Amazon, there are thousands of small businesses that will be affected by this legislation. Many companies will be forced out of business completely if the new legislation is put into place. We respectfully submit that members of Congress vote against the Marketplace Fairness Act and consider enacting a less burdensome legislation such as a reporting statute.

Questions may be addressed to:

> James H Sutton, Jr., CPA, Esq.
> Committee on State and Local Tax – Chairman
> American Association of Attorney – Certified Public Accountants
> JamesSutton@FloridaSalesTax.com
> (813) 367-2134

Sincerely,

Bob Driegert

Robert S. Driegert, Esq., CPA
President

MARKETPLACE FAIRNESS ACT OVERBURDENS INTERSTATE COMMERCE
REMOTE SALES REPORTING: A SIMPLER SOLUTION TO ACHEIVE SAME GOALS

Policy Position

Position: *Even though the members of the* ***American Association of Attorney-CPAs*** *(AAA-CPA) are some of the most likely professionals to thrive in a world with the increased state tax jurisdictional reach, our members strongly believe that the proposed Marketplace Fairness Act will overburden our national economy and the legislation's goals could be better achieved by much less burdensome means. The primary goals of the proposed Marketplace Fairness Act are to correct two injustices in our country's economy: (1) to provide an equal playing field between remote sellers and brick and mortar sellers with regard to sales/use taxes and (2) allow states to collect use taxes on billions of dollars of consumer transactions that are currently escaping taxation. While achieving these goals, the Marketplace Fairness Act does so in a way that will often cost more for remote sellers to administer than the tax revenues provided to the states. In addition, the increased tax liability to remote sellers for mistakes in use tax compliance dwarf the deceptively narrow limitations of liability provided in the proposed legislation.* ***If Congress is going to once again wade into the realm of carving out exceptions to the constitutional limitations on states' jurisdiction reach for tax purposes, then it is the duty of Congress to do so by the means that is the least burdensome on interstate commerce.*** *It is the position of the AAA-CPA that a simplified, remote sales reporting requirement could achieve the same goals without the overburdening effects of the proposed legislation.*

Explanation: Our members recognize that there is an injustice occurring in our economy with regard to the ability of states to collect use taxes on remote sales of goods and services. We also recognize the unfair competitive disadvantage to brick and mortar retailers in favor of remote sellers whose customers are able to purchase the same goods and services without the states having a reasonable means to enforce their use tax laws on the typical remote sale. At the same time, we have reached a profound time in our country's history when small, local businesses and consumers can cheaply and easily find each other and conduct business from anywhere in the country via the internet marketplace. This is the epitome of a highly advanced, capitalistic marketplace that benefits each and every person in this country as well as the country as a whole. We believe that this evolving electronic commercial marketplace should be allowed to grow and thrive with the fewest government restrictions possible.

The Commerce Clause of the U.S. Constitution (Art. 1, Sec. 8, Clause 3) was a profound expression by the founders of our great country that if our nation is going to have a thriving national economy, then we need commerce to be able to flow freely between the states without undue burdens. So the states gave up their power to regulate interstate commerce by creating the Commerce Clause with the expectation that Congress and Office of the President will act in the best interests of the national economy instead of merely the coffers of the many states. Almost since the start of the first state sales tax enacted by Mississippi in 1930, states have been battling the jurisdiction limitation in our court systems trying to force remote sellers to be collection agents for use tax purposes instead of enforcing the state's laws against its own citizenry. The U.S. Supreme Court, for the most part, has enforced the Commerce Clause to protect remote sellers from the reach of tax hungry states who already have jurisdiction over the in-state purchasers of the taxable goods and services. Time and time again, our courts have scolded states for trying to overstep their jurisdictional reach on remote sellers instead of enforcing their own use tax laws, while inviting Congress to step in to provide some reasonable relief

to the controversy.[1] In the rare occasions when the courts have not protected remote sellers from over reaching state taxing authorities, Congress has stepped in to protect the remote seller.[2]

Proponents of the proposed legislation would like you to believe that free or low cost software can so simplify the collection process for remote sellers that the time and effort to comply will be minimal. This misconception could not be farther from the truth. It is true that a monkey, with a little help from software, can calculate the sales tax rates based on zip codes of the purchaser. Given the advances in technology, the difficult part is not the sales tax rate. The difficulties that exist now and will be exponentially broadened under the proposed legislation for hundreds of thousands of additional remote sellers that will become collection agents for 45 states[3] and 7,500+ sales tax jurisdiction are:

- what is subject to tax,
- what is exempt from tax,
- what proof is necessary for exemption,
- when is it exempt,
- how to determine the validity of exemption certificates,
- when is it subject to tax (deposit, full payment, shipment, installment payments, etc),
- who is the responsible party for the tax (e.g., drop shipments),
- what jurisdiction's laws apply (purchasers billing address, shipping address, or other),
- when and how to refund tax,
- how to prove sales were not subject to tax under "guilty until proven innocent" statutes,
- how to manage audits from 45 states based on varying laws in 7,500+ use tax jurisdictions,
- how to keep up with all the above with constantly changing state laws and local ordinances (in 2011, 459 sales tax jurisdictions made changes to their sales taxes),[4]
- How to account for the growing liability for mistakes handling all the above.
- How to enforce these state tax laws against the remote vendors with no personal jurisdiction in the remote states. Is the Department of Justice going to expend resources to enforce the state law?
- How is a state going to enforce the criminal laws in the case of sales tax theft on remote sellers? Is the Department of Justice expected to expend resources to enforce the state law?

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[1] See, e.g., Quill Corp. v. North Dakota, 504 U.S. 298 (1992) (requiring physical presence in state before the state can force use tax collection requirements on a remote seller).
[2] For example, Public Law 86-272 was enacted in response to outcries from businesses over the decision held in *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959) to limit the state's jurisdiction reach for income tax purposes when the business' only contact with the state are the mere solicitation of orders by salesmen as long as the orders are approved and shipped from out of state.
[3] Alaska, Delaware, New Hampshire, Montana, and Oregon do not have a state sales tax, although some local jurisdictions do have a sales and use tax in some of these states.
[4] "Average U.S. Sales Tax Rate Drops -- A Little," Forbes, by William P. Barrett, Feb. 2, 2012.

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These are all the concerns small and large business owners have that the proponents of the Marketplace Fairness act do not want you realize exist. The membership of the AAA-CPA are in the trenches every day helping companies try to understand and comply with state sales/use tax laws as well as defending companies against over aggressive state tax departments trying to impose liability on companies that have honestly tried to comply with increasingly complex state use tax laws. Take it from the professionals that deal with sales and use tax controversy every day, Congress does not want to be responsible for unleashing this type of mayhem on our national economy when there is a much more simple, less burdensome way to achieve the same goals.

Take for example a company with a mere $1 million in remote sales. The company will likely generate less than $70,000 of use tax revenue considering an average state tax use tax rate of 9.6% in 2011[3] and a reasonable percentage of legitimately exempt sales. While a company will likely be able to find free or low cost software to calculate the rate of tax based on a customer's zip code, the cost of hiring an employee or outside professional that is capable of not only understanding the complexities of the use tax laws in 45 states and 7,500+ local use tax jurisdictions will likely be more than the tax revenue collected. If the company is able to absorb the cost of use tax compliance under the new legislation, then the company will likely have to hire additional personnel or outside professionals to contend with the onslaught of use tax audits from 45 states. Finally, companies will have the surprise expense of having to become responsible for the use tax when (not if) mistakes are made or exemption paperwork is missing. If you add up all the costs for complying with the new legislation, then the administrative burden placed on smaller remote sellers will exceed the use tax revenues remitted to the various states. In fact, for many smaller remote sellers with the drop shipment business model, the cost of complying with the proposed legislation could easily exceed the company's entire overhead before having to collect use taxes for all 45 states. **The members of the AAA-CPA respectfully submit that something is fundamentally wrong with tax legislation that costs more for a company to administer than the taxing authorities collect in tax revenue.**

Of course the pure brick and mortar companies believe the new legislation is a good idea because it places extremely expensive administrative burdens on remote sellers who will have to comply with use taxes in 45 states versus a brick and mortar companies only having to comply with one state's laws. The states are considering this situation from the pure self-interested point of view that "my state will get more revenue" without considering the effect it will have on the nation as a whole. This later concern is the exact reason why the founders of our country placed in the hands of Congress the sole power to regulate interstate commerce - because our founders believed that Congress would act in the best interest of the country as a whole, not the individual states. Finally, the proposed legislation imposes a state's jurisdiction over companies whose employees and owners have no vote in the state whose use tax collection laws are imposed against them.

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[3] Average use tax rate provided by Vertex, Inc. as reported in "Average U.S. Sales Tax Rate Drops -- A Little," Forbes, By William P. Barrett, Feb. 2, 2012.

AAA-CPA AMERICAN ASSOCIATION OF ATTORNEY CERTIFIED PUBLIC ACCOUNTANTS

The fundamental fallacies of the proposed legislation are even more profound given that there is a dramatically less burdensome means for addressing the states' concerns while equalizing the tax disadvantage currently born by brick and mortar businesses. The AAA-CPA strongly believes that a use tax reporting requirement similar to the recently struck down Colorado legislation would achieve the goals that states and brick and mortar companies fundamentally want to achieve without the extreme burdens on businesses.[6] Colorado, like every other state with a sales and use tax, has in place the means to efficiently send out letter audits to in state purchasers to collect use taxes due on remote sales. The only things the states don't have is access to the information concerning the remote purchases. The Colorado legislation required remote sellers to simply report sales into Colorado so Colorado could enforce its own use tax laws against its citizens or resident businesses. The US District Court of Colorado struck down the law finding that the notice and reporting requirement violated the Commerce Clause.[7] In other words, the Court correctly held that only the federal government has the power to enact such legislation. We herein ask that each every member of congress strongly consider that the path boldly attempted by Colorado is the proper path Congress should be taking.

As the proponents of the Marketplace Fairness Act often argue, technology has advanced so much that remote sales can easily be tracked and taxed. We agree and with proper information, the states can use that new technology to efficiently enforce the states' use tax laws on its own citizens and business without have to place undue burdens on multistate commerce.

Summary: The question before Congress is how to balance the injustice of the loss of sales and use tax revenue to the states and the competitive disadvantage to brick and mortar companies against the need to place the least restrictive burdens on the new and amazing commercial market place. The State and Local Tax Committee and Executive Committee of the AAA-CPA believe that while the Marketplace Fairness Act addresses the concerns of the states' loss of use tax revenue and the competitive disadvantage thrust upon brick and mortar companies, the Act does so in a way that will place crippling burdens on interstate commerce, especially on the new electronic commercial marketplace. While the media tend to focus on billion dollar companies like Amazon, there are thousands of small businesses that will be affected by this legislation. Many companies will be forced out of business completely if the new legislation is put into place. We respectfully submit that members of Congress vote against the Marketplace Fairness Act and consider enacting a less burdensome legislation such as a reporting statute. A simplified bill requiring vendors to report remote sales to the states would give the states all the information necessary to collect use tax on remote sales while solving all the burdens on interstate commerce.

[6] Col. Rev. Stat. § 39-21-112(3.5), (2010).
[7] *Direct Marketing Association v. Huber*, No. 10-CV-01546-REB-CBS (March 30, 2012).

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March 9, 2014

House Judiciary Committee
Hearing: Exploring Alternative Solutions on the Internet Sales Tax Issue

Dear Mr. Chairman, Mr. Ranking Member, and members of the Committee:

The proposed Consumer Private Report (CPR) proposal for the US retail sales tax is functionally similar to the EU's VAT Information Exchange System (VIES) that exchanges transactional data among tax administrations in the Value Added Tax (VAT). Both CPR and VIES are shared digital databases. Both could operate in real-time.

Importantly, for this discussion, the VIES works, and so should the CPR.

The biggest difference between the VIES and the CPR is that the VIES is designed to capture business-to-business (B2B) data, and the CPR will capture business-to-consumer (B2C) transactions. A second difference is that the VIES is kept by each Member State where the CPR will be a federal database.

The VIES was established in 1992 by Council Regulation.[1] It has two objectives: (1) it allows companies making taxable supplies to determine if their customers hold valid VAT IDs, and (2) it records the value of intra-EU supplies. It is the second attribute of the VIES that allows national VAT administrators to monitor and control tax 'irregularities' in intra-EU trade. This is the aspect of the VIES that the CPR replicates.

Through the exchange of VIES data, tax authorities match cross-border intra-EU supplies (ICS) by registered persons with intra-EU acquisitions (ICA) by taxable

[1] VAT Directive, Article 22(6)(b), Council Regulation 218/92, Article 4(1) & 4(4)

persons. VIES data is compiled from bi-monthly sales statements of registered companies.

The VIES however is not state-of-the-art. It is not real-time, and considerable audit resources are still needed to follow the captured data into the granular or transactional detail needed for tax assessment. Proposal have been made to the EU Commission on how to take the "next step" with its VIES. (See: *DICE – Digital Invoice Customs Exchange*, at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2314478)

This "next step," DICE, will transmit to the "cloud" a secure (encrypted) record of each commercial transaction. It is a highly cost-effective, secure, and privacy respecting system that operates in real-time. It captures B2B as well as B2C transactions.

It is designed to combat B2B frauds (MTIC and MTEC) as well as B2C sales suppression (Zappers and Phantomware). DICE is operational in the East African Community where Rwanda has taken the lead.[2] DICE will be demonstrated at the California State Board of Equalization's (BOE) *2014 Sales Suppression and Detection Techniques Symposium* April 28-29, 2014 in Pasadena California. This government tax agencies (only) event, sponsored by the BOE could well lead to consideration of a state-of-the-art CPR that would integrate the DICE technology adopted in the EAC into a domestic solution.

Sincerely,
Richard T. Ainsworth

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[2] See: *Rwanda -- Cutting-Edge VAT Compliance* at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2327521 and *VAT -- East African Community: The Tradable Services Problem World-Class Solution* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2310659)

Mr. GOODLATTE. Thank you, Mr. Sutton.
Mr. Crosby, welcome.

TESTIMONY OF JOSEPH R. CROSBY, PRINCIPAL, MULTISTATE ASSOCIATES INCORPORATED

Mr. CROSBY. Chairman Goodlatte, Ranking Member Conyers, and Members of the Committee, I applaud you for taking the time today to shine light on this important and critical issue of leveling the playing field between remote and Main Street commerce. Fifteen years ago I testified before the Federal Advisory Commission on electronic commerce. In reviewing that testimony, I was struck by the fact in many ways how little changed in the intervening period.

My comments from 1999 still ring true. Simplification is the only solution that removes an objectionable burden from vendors without shifting the burden to other parties. Simplification is the only solution that can lead to a level playing field.

In the wake of the Commission's work, the States came together with vendors, both online and offline, state tax experts, and other interested parties to develop the Streamline Sales and Use Tax Agreement. The benefits of that agreement—a simplified and more uniform sales tax system—accrues almost exclusively to sellers. Viewed from that perspective, it is astonishing in some ways that 24 States actually adopted the agreement in whole.

There are two main stumbling blocks for the remaining States in adopting the agreement. The first and most obvious is that there is no guarantee that it will lead to collection authority. Again, as I testified to in 1999, States may be unwilling to embark on radical change without a clear idea of the exact level of change that the Congress will demand.

The other stumbling block is the agreement requires States to make changes that apply both to remote and intrastate commerce. As noted in the staff summary for this hearing, many States are hesitant to surrender their autonomy over internal taxing policy.

The decision to apply the agreement both to remote and intrastate activity was well considered. The goal of the agreement was not merely to obtain collection authority for the States, but also to simplify sales tax collection for all sellers, both remote and Main Street sellers. That was and is a laudable goal, but it has proved too ambitious for many States in the absence of congressional authority.

An alternative framework would be to fashion an interstate agreement that focused exclusively on remote sellers and remote sales. Such an agreement would allow States to retain full autonomy over intrastate sales while providing sufficient simplification and uniformity to minimize the sales tax collection burden on remote sellers.

If such an alternative framework is to be pursued, it must be defined by Congress. States within the existing streamlined agreement would be unwilling to make further changes without certainty that those changes will lead to collection authority. States outside the agreement are unlikely to adopt something in the absence of congressional action because it would simply prove the position that they have taken today.

Like the existing streamlined agreement, an alternative framework would require numerous specific elements, but those elements would only apply to remote sellers in remote commerce. My written statement includes a detailed discussion of the elements that should be incorporated into an alternative framework.

One caveat is that the alternative framework would create two separate sets of sales tax rules with which most sellers would be required to comply. We tend to think that remote sellers and Main Street sellers are in their own categories. In reality, every seller, with very few exceptions, is a nexus seller in one or more States and a remote seller in other States. A Federal law that differentiates between nexus and remote commerce will require sellers to comply with two different sets of sales tax rules based on their status as a nexus seller or a remote seller.

Several other options are being presented to you today. With the exception of Mr. Moschella's proposal, all of them were considered and rejected as unworkable by State tax policy experts, even before the Advisory Commission concluded its work. The new veneers applied to these concepts and presented today cannot remedy their fundamental flaws.

I began my testimony by noting that in many ways, little has changed in the past 15 years. In other ways, however, the environment we live in today is dramatically different. Fifteen years ago, sales tax simplification was just an idea. Today 24 States have adopted it. Fifteen years ago, very few governors were engaged on this issue. Today governors across the country are calling upon you to act.

Sales tax collection software is no longer just a concept. It is working today for thousands of online sellers. E-commerce itself has grown dramatically. Seven percent of all retail sales are now comprised of e-commerce, which is a tenfold increase over 15 years ago. And there have been 17 consecutive quarters of double digit increases in remote commerce.

Finally, elected State leaders across this country are proposing bold tax reforms that would help create jobs, increase investment, and lead to higher wages. Those reforms are imperiled by an eroding sales tax base resulting from e-commerce.

Some have asked why there is an urgency to address this issue now. There is an urgency because retailers who have invested in your communities are at a disadvantage because of governmental policies. The urgency is about government picking winners and losers in the marketplace. The urgency is because State and local governments, as you know, do not have the luxury of borrowing to balance their budgets or the time to kick the can down the road.

This is not about retailers with outdated business models not wanting to compete. This is about businesses that have made investments in your communities and their inability to compete on a level playing field. It is not about State and local governments asking for new revenue. It is about elected State and local leaders who have made tough decisions to reform their sales tax systems, but have been hamstrung in imposing those new changes because of congressional inaction.

It is not about protecting consumers who knowingly or not are evading existing sales tax laws. It is about helping those of your

constituents who are currently doing their honest best to comply with the existing sales tax laws and taxes that are owed.

Mr. Chairman, Members of the Committee, thank you for your time. I look forward to any questions you may have.

[The prepared statement of Mr. Crosby follows:]

Testimony of

Joseph R. Crosby

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On the Issue of

Exploring Alternative Solutions on the Internet Sales Tax Issue

Before the

United States House of Representatives
Committee on the Judiciary

March 12, 2014

Chairman Goodlatte, Ranking Member Conyers and Members of the Committee, I am Joe Crosby, a principal with MultiState Associates. I have devoted most of my professional life to state tax policy questions, and in particular, to state taxation of interstate commerce.

I appreciate the opportunity to testify today. I advise many businesses and trade associations on state tax policy issues, and my firm works closely on sales tax collection issues with several large retailers and their associations. However, I do not appear here on behalf of any client. The views I will express reflect my independent professional judgment.

Advisory Commission on Electronic Commerce

Fifteen years ago, I testified before the federal Advisory Commission on Electronic Commerce. In reviewing that testimony in preparation for today, I was struck by the fact that, in many ways, little has changed in the intervening period with regard to the issue before you, which is how best to facilitate collection of sales taxes on remote sales.

My comments from 1999 still ring true:

> Simplification of the sales and use tax system is the only solution. Simplification is the only solution that removes an objectionable burden from vendors without shifting a burden to other parties. Simplification is the only solution that can lead to a level playing field, which I define as an equitable, consistent, easily administered, and technologically-neutral sales and use tax system.

If, as I contend, my assertion was correct then and remains correct now, why has simplification failed to take root in all sales tax states? Why have many of the sales tax states declined to adopt the Streamlined Sales and Use Tax Agreement?

Streamlined Sales and Use Tax Agreement

Today, the benefits of the Streamlined Agreement today accrue primarily to sellers. The sales tax simplifications within the Streamlined Agreement benefit sellers by reducing the administrative costs and uncertainty associated with sales tax collection. The mere fact that 24 states now have identical administrative provisions and definitions also drives reduced costs for sellers. The only direct benefit for states that are party to the Streamlined Agreement is a modest revenue stream from approximately 2,000 sellers who have volunteered to collect sales taxes in all Streamlined states. The real potential

benefit to states, gaining from Congress the authority to require remote sellers to collect legally owed sales taxes, has yet to be realized.

Viewed from that perspective, it is surprising that 24 states have simplified and made uniform their sales tax systems despite receiving little direct benefit. For the states that have not adopted the Streamlined Agreement, the pain of simplification today is greater than the potential future benefit of federal authorization of remote sales tax collection.

There are two main stumbling blocks to the remaining states adopting the Streamlined Agreement. The first, and most obvious, is that there is no guarantee that adopting the Streamlined Agreement will lead to collection of legally due sale taxes by remote sellers. As I testified fifteen years ago, "States may be unwilling to embark on such a radical change to any major component of their revenue systems without a clear idea of the exact level of change [that the Congress will demand]." Unless and until the Congress sets forth a clear path by which states can obtain the authority to require remote sales tax collection, there is no incentive for the remaining states to simplify their sales tax systems.

The other stumbling block is that the Streamlined Agreement requires states to make changes to their sales tax systems that apply both to remote and intrastate activity. As noted in the hearing summary, "many states...are hesitant to surrender autonomy over their internal taxing policy."

The initial decision for the Streamlined Agreement to apply both to remote and intrastate activity was well considered. From many perspectives, it remains the correct decision. The goal of the Streamlined Agreement was not merely to obtain authority to require remote sellers to collect tax, but also to make the sales tax system less burdensome and more efficient for all sellers. That was and is a laudable goal, but it has proved thus far too ambitious for many states in the absence of a Congressional guarantee that the effort will be rewarded.

An Alternative Framework: Simplification for Remote Sellers and Remote Sales

An alternative framework would be to fashion an interstate agreement that applied only to remote sellers and remote sales. Such an agreement would allow states to retain full autonomy over intrastate sales while providing sufficient simplification and uniformity to minimize the sales tax collection burden on remote sellers.

Such an alternative framework must be defined by Congress. After fifteen years of difficult substantive and political discussions among state and local governments, the existing Streamlined Agreement states would have no inclination to make further changes to their

sales tax systems without certainty that those changes would automatically provide authority to require remote sales tax collection. And the states that never adopted the Streamlined Agreement because of skepticism that Congress would ever grant such authority will undoubtedly take continued Congressional inaction as proof of their position.

Like the existing Streamlined Agreement, the alternative framework would require numerous, specific elements, but those elements would be directed at remote sellers and remote sales only. The necessary elements fall into three buckets.

The first bucket includes substantive simplifications to minimize the burden of tax administration. Examples of these simplifications include a single point of registration for sales tax collection in all states, a single uniform sales tax return, and a single point of remittance for sales taxes for all states.

Theoretically, this bucket could also include simplifications to sales tax bases, rates and sourcing regimes for remote sales but not for intrastate transactions. Addressing bases, rates and sourcing, however, would create challenges for taxpayers (purchasers) and nexus (in-state) sellers. A taxpayer could be placed in the position of having a tax liability in a state different than the tax collected by the remote seller because of base, rate or sourcing differences between the federal standards and state law. Similarly, sellers would carefully need to determine, for each state, whether they are "remote" or "nexus" sellers and follow the appropriate federal or state rules. Such a determination is not easily made, and the status of a seller as "remote" or "nexus" in a state is subject to change based on the activity of a single employee (where such activity is unlikely to be known by those in the company required to comply with sales tax laws).

The second bucket addresses software and related services to facilitate the collection of tax under a simplified system. Remote sellers would have the option to choose from different software and service providers whose programs work in all sales tax states, and that software and related services would be provided free of charge to the remote seller. The software would be required to be capable of calculating sales and use taxes due on each sale at the time the sale is completed, filing sales and use tax returns and being updated to reflect tax rate changes or tax base changes. It may also be advisable to include provisions to address the costs remote sellers will face to integrate such software into their existing systems.

The final bucket deals with sales tax audits and enforcement. The alternative framework should include a "consolidated audit agreement" among the states that provides that one state shall have the authority to audit a remote seller on behalf of all states. The remote seller should have the option to challenge the findings of such an audit in the state of its

choosing. The alternative framework should also exempt smaller sellers that use certified software from being subject to audit at all.

The appropriate level at which to set the small seller audit exemption is a purely a question for the Congress, but recent research from the Small Business Administration (SBA) is helpful in this regard. According to the SBA study, there are more than 5 million online sellers. The vast majority of those sellers are very small; if the threshold for audit exemption was set at $5 million in annual sales, then, according to the SBA, only 750 online sellers would be subject to audit. In other words, a $5 million threshold would exempt 99.99% of all online sellers from audit. A threshold of $1 million would exempt 99.96% of all online sellers; $500,000 would exempt 99.93% of online sellers; and a threshold as low as $150,000 would still exempt 99.76% of all online sellers.

Last year, the Committee on the Judiciary released a set of seven principles by which it would evaluate proposals to facilitate the collection of sales taxes on remote sales. I have attached at the end of my testimony an evaluation showing how this alternative framework adheres to the principles along with a discussion of various options to implement the principles in a legislative proposal. This alternative framework should be designed to dovetail with the existing Streamlined Agreement wherever possible. Although the alternative framework is limited to remote sales, it would act as a floor, not a ceiling, for state simplification efforts. In other words, it would not prevent a state from extending the benefits and protections for remote sales and remote sellers to intrastate sales and nexus sellers, if the state so chooses to do so.

One caveat to this alternative framework, which I alluded to previously, is that it would create, de facto, two different sets of sales tax rules with which most sellers would be required to comply. The vast majority of sellers, both online and offline, are nexus sellers in some states and remote sellers in others. According to the aforementioned SBA report, large internet sellers—the top 750—currently collect sales tax in an average of 18 states. A federal law that differentiates between nexus and remote commerce will require sellers to comply with two different sets of sales tax rules depending upon their status as a nexus seller or remote seller. If the alternative framework is limited to administrative simplifications and protections for remote sellers, compliance with two sets of rules will be less difficult for such "dual status" sellers than if the alternative framework implicates the imposition of tax and taxability determinations (product definitions, sourcing, tax rates, etc.).

A second caveat to the alternative framework is that it creates an incentive for states to narrow the pool of remote sellers to the greatest extent possible. In other words, if the simplifications and protections are only afforded to sellers defined in federal law as "remote sellers," states will have an intrinsic interest in stretching the concept of nexus as

much as possible and to assert that sellers are "nexus" and not "remote." This is not a trivial issue: distinguishing between nexus and remote sellers essentially guarantees, over time, that the simplifications and protections provided by federal legislation will be enjoyed by an ever diminishing set of sellers.

Other Options

Four other options are being presented to you today. Interestingly, three of them are not the least bit novel. Origin sourcing, reporting by remote sellers to facilitate use tax collection and the International Fuels Tax Agreement model were all discussed and debated during the proceedings of the Advisory Commission on Electronic Commerce. In fact, all three concepts had been considered and rejected as incomplete solutions by state tax policy experts, economists and legal scholars even before that Commission began its work. The final concept—banning interstate commerce—is indeed new and speaks for itself.

Origin Sourcing

Origin sourcing is peddled as the simplest of all solutions: retailers must know and comply with only one set of sales tax rules. It avoids requiring a retailer to comply with a "foreign" state's tax laws. It is also alleged to promote tax competition.

It is true that origin sourcing is simple, but it is better characterized as simplistic. In return for simplifying tax collection for sellers and ensuring that they are required to comply only with tax laws in states in which they have a physical presence, origin sourcing requires your constituents to pay taxes to other states, states in which they may never set foot and have no vote. The only way a taxpayer can avoid paying taxes to another state under origin sourcing is to never purchase goods from an out of state seller. Origin sourcing is the ultimate manifestation of taxation without representation.

The flaws of origin sourcing do not stop there. It also acts as a de facto tax on exports and a complete tax exemption on imports. To be clear, origin sourcing would exempt all foreign sales into the United States from sales tax and would impose sales tax on many exports from the United States to foreign countries. This is but one of the many reasons that no modern economy employs origin sourcing for cross border sales (or consumption) taxes.

Finally, the assertion that origin sourcing promotes tax competition is misguided at best. States like Florida and Texas attract residents for many reasons, one of which is the lack of a personal income tax. That is tax competition: people move to those states to benefit

from what they perceive to be a superior tax system. Residents of those states are well aware that the government they demand requires a certain level of resources, and, consequently, sales taxes in those states are above the national average. Suggesting that tax competition is furthered when a Florida or Texas resident places an order from an online company whose "origin" is in a state without sales tax is farcical. That is not tax competition; it is tax arbitrage and should not be encouraged by the federal government.

For these reasons, Professor Charles McLure, a senior fellow with the Hoover Institution and former official in the Treasury Department under President Reagan, testified against origin sourcing for state sales taxes in a hearing before the Senate Committee on the Budget 14 years ago. He also presented at that time an "Appeal for Fair and Equal Taxation of Electronic Commerce," which opposed origin sourcing and was signed by more than 170 tax economists and professors of law.

Reporting and Use Tax Collection

A second concept is to require remote sellers to report sales to the purchaser's home state. The state would then use this information to enforce its use tax. This approach has been attempted by states before, both cooperatively and by mandate. In the late 1990s, groups of states in both the Northwest and Northeast entered into agreements with each other and with businesses to share information that would facilitate use tax collection. The results of these efforts were not encouraging. More recently, Colorado and a few other states have attempted to mandate different types of notification and reporting.

Congress has authority to make some type of reporting mandatory. At best, however, mandatory reporting and use tax collection is a poor alternative to collecting the appropriate tax at the time a transaction is completed. Taxpayers would be required annually, or perhaps more frequently, to compile all of the notifications they receive from all remote sellers they patronize and complete a use tax return reporting—and paying—unpaid taxes. In aggregate, taxpayers would be required to file hundreds of millions of additional tax returns annually, and states would be required to process and audit those returns. Some consumers may endeavor to avoid making purchases from remote sellers in an effort to avoid the filing burden and need to make payment in a lump sum rather than on each transaction.

The larger concern with this approach relates to those audits. A remote seller would not simply be able to report to states the total amount of purchases made by a taxpayer in a year, or even the amount of each transaction made in a year. That information would be useless from a tax compliance perspective, because not all sales are taxable. Indeed, a remote seller would be required to report line item detail of each and every item a taxpayer purchased. One need not be a privacy expert to appreciate the implications of

such reporting. Consumers are unlikely to be comfortable with tax administrators having detailed information about their purchases of books, movies, medical devices, prescription drugs, entertainment products, etc. In fact, a federal district court, in a case involving North Carolina, held that such detailed reporting violates the First Amendment of the United States Constitution and the federal Video Privacy Protection Act.

The Congress has authority under the Commerce Clause to mandate some type of reporting. However, the First Amendment may bar the Congress from requiring the type of reporting sufficient for tax administrators to determine whether an item that has been purchased from a remote seller is taxable. Without that information, there can be no enforcement of the use tax, placing us back in exactly the position we are today.

Some have suggested these privacy concerns can be avoided by creating a federal database, or imposing an unfunded mandate on states by compelling them to fund reporting regimes run by third parties without providing the states with the authority to require collection at the time of sale. These are desperate efforts to overcome the fundamental flaws with such a regime. Clearly, the concept of reporting alone is no solution to the problem at all.

International Fuels Tax Agreement

Finally, I turn to the International Fuels Tax Agreement (IFTA) as a model for remote sales tax collection.

The IFTA was initiated in 1983 by Arizona, Iowa and Washington as an effort to ease fuel tax compliance for states and interstate commercial motor vehicles. In 1984, the Congress supported a National Governors Association (NGA) working group that incorporated IFTA and a regional fuels tax agreement between northeastern states. By 1990, 16 states had adopted the model created through the NGA process. IFTA became mandatory through the 1991 enactment of the Intermodal Surface Transportation Efficiency Act (ISTEA). ISTEA prohibited states from enforcing fuel taxes on interstate carriers after 1996 unless the state complied with IFTA.

IFTA operates on a "base jurisdiction" model. The base jurisdiction is the state where the qualified motor vehicle (QMV) is registered. Under the model, QMVs continue to pay fuel taxes at the time of purchase. QMVs also track miles traveled in each jurisdiction. QMVs file a quarterly return with the base jurisdiction indicating taxes paid in each jurisdiction and miles traveled in each jurisdiction. The base jurisdiction collects additional taxes due from, or pays refunds owed to (in aggregate) the QMV. The base jurisdiction, operating through a clearinghouse maintained by the International Fuel Tax Association, Inc., distributes revenue owed to/from the various states in which the QMV operated during the

preceding quarter. Finally, the base jurisdiction has responsibility for auditing QMVs on behalf of all IFTA jurisdictions.

The Streamlined Agreement was initiated by the NGA and the National Conference of State Legislatures (NCSL). Given those organizations' roles in developing and implementing IFTA, there has been discussion since the beginning of the Streamlined Agreement regarding the IFTA model and its applicability to sales taxes. In many ways, the Streamlined Agreement mirrors IFTA (uniform definitions, Streamlined Sales Tax Governing Board, Inc. to administer the agreement, a single system to register sellers in all jurisdictions, certified software providers for sales tax compliance, etc.).

Despite these similarities, there are fundamental political and substantive considerations that work against the base jurisdiction concept for remote sales tax collection.

The first political consideration is that the IFTA was broadly supported by the affected industry. In the sales tax arena, there are deep differences within the remote seller community. IFTA is also targeted at taxpayers; QMVs had nexus and an obligation to pay, and taxes were being collected. The only question was administrative simplification for taxpayers and states. Finally, fuel taxes, although an important source of revenue, are dwarfed by sales tax revenues. Fuel taxes are a dedicated revenue source more akin to a user fee, while sales taxes are general fund revenue sources in nearly every state (and locality) in which they are levied. States (and localities) will be very reluctant to relinquish control over a significant portion of their first or second largest general revenue source to their sister states.

From a substantive perspective, as is the case with QMVs, remote sellers currently must register to collect sales tax in their "base jurisdiction." Unlike QMVs, sellers with operations in multiple states cannot choose a single jurisdiction as a base jurisdiction; they must register to collect in each state in which they have a store or operation. Thus, for sellers who have a location in more than one state and sell remotely into other states, there is an initial question regarding which jurisdiction is the base jurisdiction. Perhaps it could be the jurisdiction where orders for remote sales are received, accepted and/or shipped, but for larger remote sellers those activities are likely geographically distributed as well.

Along the same lines, a seller will be a nexus seller in some states and a remote seller in others. How is the base state auditor easily to distinguish between nexus sales, on which tax should have been collected and remitted to the destination state, and remote sales, on which taxes should have been collected and remitted to the base state for further distribution to the destination states? The status of a seller in each state (as nexus or remote) will also change over time, perhaps frequently. That would require the seller to

register and terminate registration in nexus states and shift tax collection to/from the base jurisdiction.

Assuming these hurdles are crossed, the next one up is sheer number of taxable goods and services and the lack of uniformity among the states with regard to defining those goods and services. With IFTA, there is essentially only one product being sold: diesel fuel. There is one rate per state (there are no local rates or base differences). There are also no exempt goods or services or exempt purchasers (QMVs are by definition not exempt from fuels taxes). Thus, there are no real questions on audit regarding whether the good or service being sold was subject to tax, or whether the purchaser buying the good or service was subject to tax. In other words, the IFTA audit function is essentially an audit of the QMV's records of miles traveled and taxes paid.

Furthermore, all states participating in IFTA levy fuel taxes. If a base jurisdiction model were applied to sales tax, states without a sales tax, and thus no competency to audit sales tax, would be required to audit sales tax. Even states with sales taxes would be hard pressed to fairly audit based on the laws of other states. Finally, it could be argued that imposing a base state model, particularly on a state that does not have a sales tax, is an unfunded federal mandate.

Some of these hurdles may be able to be overcome, especially in the context of seller use of certified service providers (CSPs). With a CSP model, the audit could be limited to the CSP rather than the seller. However, absent a mandate that sellers use a CSP, or seek certification of their own compliance systems, a base jurisdiction model would require states to audit based on laws they are unfamiliar with, which could be a detriment to sellers.

The IFTA model is valuable and has informed the Streamlined Agreement as well as the alternative framework I have presented here. However, the IFTA cannot simply be bolted on as a solution to the problem of remote sales tax collection.

Conclusion

I began my testimony noting that, in many ways, little has changed with regard to this debate in the past fifteen years. In other ways, however, the differences between then and now are stark.

- **State Legislatures:** Fifteen years ago, sales tax simplification was only an idea. Now, 24 states have implemented significant simplifications and harmonized definitions, administrative provisions and other critical features of sales taxes while

maintaining sovereignty over fundamental aspects of their tax systems. This is a better track record than the IFTA had before it was mandated by Congress.

- **State Governors:** Governors across the country strongly support Congressional action to authorize remote sales tax collection. Governors who have spoken or acted in favor of a level playing field for all sellers include Paul LePage (ME), Mike Pence (IN), Chris Christie (NJ), Rick Snyder (MI), Robert Bentley (AL), Gary Herbert (UT), Butch Otter (ID), Nathan Deal (GA), Bill Haslam (TN) and Dennis Daugaard (SD).

- **Technology:** Software to calculate sales taxes due, remit taxes collected and file tax returns has advanced dramatically. For several years now, remote sellers who have volunteered to collect under the simplified system in the Streamlined states have had access to several software and service providers, free of charge, to handle sales tax administration.

- **Ecommerce:** According to the Census Bureau, ecommerce is ten times larger as a percentage of retail sales than it was fifteen years ago, rising from 0.7% of total retail sales in Q4 1999 to 7.0% of total retail sales in Q4 2013. Ecommerce has grown at double digit rates for 17 consecutive quarters and for all but six quarters since records were first kept.

- **State Tax Reform and Tax Reductions:** The two worst state fiscal recessions since the end of World War II have occurred in the past fifteen years. In response to revenue volatility, expected reductions in future federal revenue sharing and changes in the economy, elected state leaders are proposing bold reforms to make their economies, and our country, more competitive. In the past year alone, more than 10 states have debated extensive reforms that would decrease taxes on returns to investments in people, property and capital and instead relied more heavily on consumption taxes. These proposals all are projected to increase employment, raise wages and attract investment. Erosion of the sales tax base from uncollected taxes on remote sales seriously undermines these efforts. Already, eleven states have adopted or are considering proposals dedicating new revenues from remote sales tax collection to cuts in other taxes.

Some have asked why there is urgency to address this issue. There is urgency because retailers who have invested in your communities are at a severe disadvantage to those who have not because of government policies. The urgency is about government picking winners and losers in the marketplace which results in actual job losses in your districts. There is urgency because state and local governments do not have the luxury of borrowing to balance budgets or of time to kick problems down the road.

This is not about retailers with outdated business models not wanting to compete. This is about businesses that have made investments in your communities and their inability to compete on a level playing field in terms of tax policy with their online only counterparts who have not made a similar investment. It is not about state and local governments asking for new revenue. It is about elected state and local leaders who have made tough decisions to reform their sales tax systems but are hamstrung in their efforts by Congressional inaction. It is not about protecting consumers who, knowingly or not, evade tax laws. It is about easing the tax compliance burden on your constituents who make an honest effort to fulfill their duty as citizens and pay taxes they legally owe.

Mr. Chairman, I again thank you for the opportunity to speak before this Committee today. I welcome any questions that you or the Committee members may wish to pose.

Appendix: Comparison of Alternative Framework to Committee on Judiciary Principles on Internet Sales Tax

Tax Relief

Principle: Using the Internet should not create new or discriminatory taxes not faced in the offline world. Nor should any fresh precedent be created for other areas of interstate taxation by States.

Discussion: The Internet Tax Freedom Act, which expires in 2014 and which prohibits new or discriminatory taxes on online commerce, addresses the first sentence of this principle.

Under the Commerce Clause, as interpreted by the U.S. Supreme Court, sellers that do not have substantial nexus with a State—Remote Sellers—are not required to collect sales tax due on transactions with customers in the State. Any federal legislation seeking to rectify the disparity between Remote Sellers and those who are required to collect—Nexus Sellers—must, by definition, grant authority to the States to compel Remote Sellers to collect tax. To satisfy this principle, that grant of authority must be narrowly construed so that it applies only to the collection of State and local sales and use taxes and not to other taxes.

Implementation Options:

1. Provide that the Act shall not be construed as authorizing a State to subject a Remote Seller or any other person to franchise, income, occupation, or any other type of taxes other than sales and use taxes, affecting the application of such taxes, or enlarging or reducing State authority to impose such taxes.
2. Provide that the Act shall not be construed to create taxable nexus or alter the standards for determining taxable nexus between a person and a State or local jurisdiction.
3. Provide that nothing in the Act shall be construed as encouraging a State to impose sales and use taxes on any products or services not subject to taxation prior to the date of the enactment of the Act.
4. Provide that the sole recourse for States to require Remote Sellers to collect sales tax is to meet the requirements of the Act ("field preemption").

Tech Neutrality

Principle: Brick & Mortar, Exclusively Online, and Brick & Click businesses should all be on equal footing. The sales tax compliance burden on online Internet sellers should not be less, but neither should it be greater than that on similarly situated offline businesses.

Discussion: As a result of the U.S. Supreme Court's interpretation of the Commerce Clause, Remote Sellers have two distinct advantages over Nexus Sellers. First, Remote Sellers cannot be legally required to collect tax, and thus Remote Sellers do not bear the administrative burden of sales tax collection that Nexus Sellers bear. Second, because few taxpayers actually pay use tax where sales tax is not collected, Remote Sellers also enjoy, in most of the country, a non-trivial price advantage over Nexus Sellers. It is worth noting that only non-U.S. businesses can be a Remote Seller in every State (U.S. businesses have substantial nexus with at least one State even if that State does not impose a sales tax) and that only some businesses are Nexus Sellers everywhere. Most businesses are Remote Sellers in some States and Nexus Sellers in others.

Implementation Options: The alternative framework would authorize States to require all sellers to collect sales tax on Remote Sales. To address the burden the may place on Remote Sellers, the Act would require States to simplify the administration of sales tax as a precondition for being granted the authority to require Remote Sellers to collect tax. There are nearly as many opinions as to what constitutes "true simplification" as there are people involved in the debate. The following list focuses on the simplifications that are most meaningful to Remote Sellers. It is worth noting that simplifying collection for all sellers has value in and of itself and benefits the economy overall.

1. Authorize States to require all sellers to collect and remit sales and use taxes, but only as long as the State implements legislation that includes certain Minimum Simplification Requirements.
2. Allow sellers to challenge a State's assertion that it has met the Minimum Simplification Requirements and incorporate provisions to terminate a State's authorization if it no longer satisfies the Minimum Simplification Requirements.
3. Require States to publish notice of intent to exercise authority under the Act, with a sufficient minimum period (e.g., 180 days) following the enactment of this Act and the publishing of such notice.
4. Require States to adopt, via legislation, the "Minimum Simplification Requirement" that:
    a. specifies the tax or taxes to which the authority granted by the Act applies and specifies any products or services otherwise subject to the tax or taxes identified by the State to which the authority of this Act shall not apply;

b. provides for a single, central registration system for all States;
c. identifies a single entity within the State responsible for all State and local taxing jurisdiction, sales and use tax administration and return processing;
d. provides for a single, uniform sales and use tax return for use in all States, including and all local taxing jurisdictions within the States, and provides that a Remote Seller is not required to file sales and use tax returns any more frequently than non-Remote Sellers;
e. provides for a single point of remittance (which could be a single State) for Remote Sellers for all States in which the Remote Seller makes Remote Sales;
f. provides that a Remote Seller is not subject to any requirements that the State does not impose on non-Remote Sellers;
g. provides a uniform sales and use tax base among the State and local taxing jurisdictions within the State;
h. provides for the sourcing of Remote Sales consistent with the Act;
i. defines a "Taxability Matrix" as a publication indicating what sales of tangible or intangible products or services are subject to or exempt from the sales and use tax;
j. provides a Taxability Matrix, and provides that sellers shall have no liability to the State for an error was the result of any reasonable interpretation by the seller of the State's Taxability Matrix;
k. provides for the publication of a rate and boundary database by each State, and provides that any person relying on such database shall have no liability to the State or local taxing jurisdictions within the State for the incorrect collection, remittance, or noncollection of sales and use taxes, including any penalties or interest; and,
l. provides at least 90 days notice of a rate or base change by the State or any local taxing jurisdictions within the State and provides that sellers shall have no liability to the State or local taxing jurisdictions within the State for the incorrect collection, remittance, or noncollection of sales and use taxes if sufficient notice of a rate or base change was not provided.

5. Require States to provide certified software free of charge to Remote Sellers that calculates taxes and files returns in all States authorized under the Act, provides all sellers using certified software with protection from liability, and provides transitional assistance to Remote Sellers to offset implementation costs associated with such software.

No Regulation without Representation

Principle: Those who would bear State taxation, regulation and compliance burdens should have direct recourse to protest unfair, unwise or discriminatory rates and enforcement.

Discussion: Under current law, taxpayers—consumers—have direct recourse to protest unfair, unwise or discriminatory sales tax rates and enforcement through their State legislatures and courts. That right remains unaffected by any proposed Congressional response to this issue.

A Congressional grant of authority to the States permitting them to require Remote Sellers to collect tax heightens the Remote Seller's exposure to potential audits or other enforcement actions by States in which the Remote Seller has no physical presence.

To minimize this potential burden, the Remote Seller should benefit from: 1) a single audit for all jurisdictions in which the Remote Seller makes Remote Sales; 2) the right to protest any assessment arising from such an audit in the jurisdiction of the Remote Seller's choosing; and 3) a small seller exemption for Remote Sellers using a certified software provider.

Together, these provisions would minimize the audit burden on a Remote Seller and ensure that the Remote Seller has recourse to its State courts in the event of a disputed audit finding.

Additionally, it may be appropriate to exempt certain remote sellers, as discussed below, from audits and other enforcement actions.

Implementation Options:

1. Provide for a "Consolidated Audit Agreement" among the States that provides that one State shall have the authority to audit a Remote Seller on behalf of all States under the authority granted by the Act. States which choose not to enter the agreement are prohibited from auditing the Remote Seller.
2. Provide that the result of any audit conducted under the Consolidated Audit Agreement is binding on the State and local taxing jurisdictions within that State, unless such results are challenged by the Remote Seller.
3. Provide that assessments based upon an audit conducted pursuant to a Consolidated Audit Agreement shall be reviewable by a court of competent jurisdiction in any State which is a party to the Consolidated Audit Agreement upon the consolidated appeal by the Remote Seller.

4. Exempt Remote Sellers which use certified software and which fall below a certain sales threshold from audit. According to a Small Business Administration (SBA) study, there are more than 5 million online sellers. The vast majority of those sellers are very small; if the threshold for audit exemption was set at $5 million in annual sales, then, according to the SBA, only 750 online sellers would be subject to audit.

Simplicity

Principle: Governments should not stifle businesses by shifting onerous compliance requirements onto them; laws should be so simple and compliance so inexpensive and reliable as to render a small business exemption unnecessary.

Discussion: As discussed under "Tech Neutrality" (above), reducing compliance burdens will benefit Remote Sellers large and small. In addition to providing equal footing for all sellers, reducing the administrative burden imposed by State and local sales taxes reduces deadweight loss in the economy and frees up those resources for productive investments.

Implementation Options: see implementation options under Tech Neutrality.

Tax Competition

Principle: Governments should be encouraged to compete with one another to keep tax rates low and American businesses should not be disadvantaged vis-a-vis their foreign competitors.

Discussion: The current State and local sales and use tax system encourages competition between the States for residents. Individuals are free to choose between governments that impose no or low sales taxes or higher sales taxes (perhaps in lieu of other taxes, such as income taxes).

On a more granular level, State and local governments compete by exempting whole segments of commerce (e.g., excluding services from the sales tax base) or specific areas to encourage investment (e.g., exempting manufacturing machinery and equipment from sales tax).

Finally, all States incorporate destination based sourcing for Interstate Sales, which ensures that exports are free from sales tax and imports (either from another State or

another country) are on equal footing, from a sales tax perspective, with domestically produced goods or provided services.

Implementation Options: The alternative framework is open to, but does not require, a uniform tax base among all the States and a single tax rate per State. Those elements tend to diminish tax competition between State—and local—governments. The following options to promote tax competition are limited by the simplification concepts enumerated previously; in other words, States' flexibility in this area should not trump the need for a reduced compliance burden.

1. Allow States to define their own tax bases (i.e., to determine whether a product or service should be taxable or exempt).
2. Allow States to set their own tax rates
3. Avoid sourcing regimes or other provisions which would effectively exempt from tax foreign commerce (e.g., a pure origin sourcing regime would impose tax on exports but make imports tax exempt).

States' Rights

Principle: States should be sovereign within their physical boundaries. In addition, the federal government should not mandate that States impose any sales tax compliance burdens.

Discussion: Tax Competition and States' Rights are related, and the implementation options under Tax Competition fit equally well here. The principle of States Rights' brings into consideration two additional issues: 1) the treatment of intrastate sales; and, 2) an overarching concern that the Act not tread on State and local governments beyond that which is required to solve the current problem.

Implementation Options:

1. Provide that the Act does not affect intrastate sales.
2. Provide that the Act does not impose any new taxes or regulatory requirements and does not require States to impose any new taxes or regulatory requirements.

Privacy Rights

Principle: Sensitive customer data must be protected.

Discussion: Federal and State laws currently provide for the protection of sensitive taxpayer (i.e., customer) data. Those laws generally extend not only to federal and State employees who have access to sensitive taxpayer data, but also to third party contractors and others, such as sellers and employers, who may be compelled by governments to participate in the tax collection structure.

Implementation Options: Presuming that existing federal and State laws protecting sensitive taxpayer data are sufficient, the Act could simply refer to those laws. Alternatively, the Act could set a standard for the protection of sensitive taxpayer data that States must meet in order to exercise the authority granted in the Act (similar to the grant of authority being conditioned on adoption of the Minimum Simplification Requirements).

Mr. GOODLATTE. Thank you, Mr. Crosby.
Mr. Moylan, welcome.

TESTIMONY OF ANDREW MOYLAN, SENIOR FELLOW AND OUTREACH DIRECTOR, R STREET INSTITUTE

Mr. MOYLAN. Thank you. Chairman Goodlatte, Ranking Member Conyers, and Members of the Committee, thank you for the invitation to testify today. My name is Andrew Moylan. I am senior fellow and outreach director for the R Street Institute. R Street is a pragmatic, non-profit, nonpartisan think tank that operates on the motto, "Free markets, real solutions."

While we believe passionately in limited government, we also want constructive solutions to our most pressing public policy concerns. And it is in that spirit today that I ask you to consider an alternative solution to the internet sales tax issue, origin sourcing.

They say that taxes are the fine you pay for thriving too fast. And some clearly have an impulse to penalize the thriving of the internet by giving State tax collectors power as big as the internet itself. What I propose to you today is not to give internet retail a free pass or special treatment, but to truly level the playing field by specifying unified origin sourcing as the only permissible standard for taxation of remote retail sales.

In laymen's terms, what that means is origin sourcing establishing a source of an item for tax purposes as the physical location of the business making the sale while a destination sourcing scheme, like the Marketplace Fairness Act, compels tax collection based on the physical location of the buyer making the purchase. This seemingly small discrepancy makes a world of difference.

To illustrate, consider if I were to make a purchase at one of the Capitol gift shops today. Though I am an Arlington, Virginia resident, they would charge me the District sales tax, not Virginia's, on any item that I purchase because they effectively operate on an origin sourcing system. They collect based on where their business is physically located for every sale, regardless of where their customer comes from.

And what I propose is for Congress to extend its use to remote retail sales as well, yielding several important benefits. The first is that it would truly level the playing field by ensuring that all sales have tax collected on them, and that the collection standard for in-person versus remote sales is identical. As such, it would be radically simpler to administer. Businesses would only be required to comply with the tax code of their home jurisdiction, and any disputes associated with collection could be settled with local tax authorities. Finally, it would preserve important taxpayer safeguards, like the physical presence standard, ensuring that Congress does not inadvertently establish a slippery slope toward a system of State tax powers unbounded by geography.

Some might have you believe that origin sourcing is a radical departure, but the truth is that it is the overwhelmingly dominant mode of sales tax collection today. Greater than 90 percent of all retail purchases have tax collected under such a rule since it governs substantially all brick and mortar sales, and roughly half the country utilizes it for remote sales made inside a State.

Nonetheless, you have heard from some of my panelists that origin sourcing is a bad idea. They might claim that it would encourage a so-called race to the bottom where businesses would rush to locate non-sales tax States, like Montana, to avoid collection. Taxes do indeed influence firm behavior, but the incentive to escape to a non-sales tax State already exists under current law, and there has not yet been a stampede that I have seen. That is because businesses tend not to make location decisions on the basis of one tax alone. They weigh property, sales, and business taxes, as well as factors like available labor pool, access to suppliers, transportation infrastructure, and so on.

Others might say that it constitutes taxation without representation, but this misunderstands who the taxpayer is for sales tax purposes. Though the levy is theoretically passed on to the consumer, the reality is that the business bears all legal responsibility for complying with the tax. If tax is not collected on an item where it should have been, revenue agents do not approach the consumer to make up the shortfall. They audit the business. And, in fact, most States define "sales taxes" as "privilege taxes" that are levied on businesses as opposed to on individuals.

You might also hear that origin sourcing is incompatible with States' rights, but a federalist system cannot survive if States are granted the authority to exercise power beyond their borders. The commerce clause of the Constitution and subsequent jurisprudence give Congress the clear power to preempt State actions that impede the flow of interstate commerce.

What an origin sourcing rule would do is reaffirm that States are sovereign within their borders, but not beyond them. And finally a Federal origin sourcing rule would be no more prescriptive to States than would the Marketplace Fairness Act or any of the other alternatives you are considering today.

To conclude, this hearing is taking place in no small part due to the complete and utter failure of the use tax system in America. Ever since the Supreme Court affirmed the constitutionality of use taxes in 1937, States have tried in vain to concoct viable systems. But the simple reality is that use taxes are effectively not administrable.

In origin sourcing, I offer up a solution that is easily administrable, that is already used for 9 out of every 10 retail sales made today, and does not trample on important taxpayer principles the way the Marketplace Fairness Act does. I do hope you will give the concept due consideration, and I look forward to your questions.

[The prepared statement of Mr. Moylan follows:]

Free markets. Real solutions.

Statement of

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Prepared for

The Committee on the Judiciary
United States House of Representatives

Regarding the Committee's Hearing on

Internet Sales Taxation

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Introduction

Chairman Goodlatte, Ranking Member Conyers, and distinguished members of the committee, thank you for the opportunity to submit testimony regarding the issue of Internet sales tax collection. My name is Andrew Moylan and I am senior fellow and outreach director for the R Street Institute, a relatively new free market think tank with offices in Washington; Tallahassee, Fla.; Austin, Tex.; and Columbus, Ohio. R Street supports free markets; limited, effective government; and responsible environmental stewardship. It strives to craft pragmatic solutions to domestic policy challenges involving regulation, public health, the environment, tax reform and the federal budget.

I have spent a great deal of time in recent years working on Internet sales tax issues, both at R Street and with my previous employer, the National Taxpayers Union. I believe strongly that passage of legislation like S. 743, the so-called Marketplace Fairness Act (MFA), would undermine basic principles of sound tax policy, impose unequal collection burdens on businesses and constitute a substantial burden on interstate commerce

However, I also believe there is a solution to address the concern that current law is inadequate while maintaining important tax policy protections. It also meets Internet sales tax principles laid out by Chairman Goodlatte late last year. The solution is to extend the simple "origin sourcing" collection standards already in use nationwide for brick-and-mortar sales to all remote sales as well. This would ensure that all retail sales are governed by the same straightforward rules, requiring tax collection based on the physical location of the business, not the residence of the buyer.

Current Law

Before discussing the failures of the Marketplace Fairness Act and the contours of an origin-sourcing solution, I'd like to summarize the law as it stands today. 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. In other words, only a legitimate physical presence in a state triggers collection requirements. This rule applies equally to traditional brick-and-mortar sellers as well as online-only and so-called "brick-and-click" businesses that sell through retail locations and over the Web.

The rule is the result of a 1992 Supreme Court case, *Quill v. North Dakota*, where a Delaware-incorporated office supplier with no presence in North Dakota was found to have no obligation to collect and remit on the latter state's behalf. The court held that extraordinary sales tax complexity would render 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, individual customers who reside in states with a sales tax are required to pay "use tax" in lieu of conventional sales tax on items purchased in other states. The use tax regime, which relies on self-reporting, is seen as ineffective, in part because most taxpayers are simply unaware of their obligations. This makes enforcement of use tax difficult, expensive and hugely unpopular, since

it would require intrusive audits of a state's residents to determine legitimate use tax obligations. As a result, states have been clamoring for the federal government's permission to instead allow them to force out-of-state businesses to collect their sales taxes, a change that would represent a dramatic expansion of state taxing authority and would untether tax policy from the basic limiting principle of physical presence. *Quill* has served to protect consumers and businesses on whom the legal requirement to collect and remit sales taxes would be placed from substantial compliance burdens imposed by overeager revenue agents in "foreign" states.

Passage of the MFA or similar legislation would enhance states' audit and enforcement power such that it would no longer end at their borders. It would give states license to enforce tax rules on businesses outside their jurisdiction, resulting not just in damage to Internet-based businesses but substantial compliance and interstate commerce burdens that could threaten to dent our fragile economic recovery.

To understand why origin sourcing is a superior solution, however, requires a discussion of the many problems inherent in the MFA.

Marketplace Fairness Act Dismantles Vital Taxpayer Safeguard

Contrary to the claims of proponents, current law is not a "loophole" implemented in a deliberate attempt to advantage Internet retailers. Instead, the *Quill* 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. It is broadly accepted as the appropriate boundary which states must observe when asserting tax prerogatives. Physical presence is a constraint on tax collectors that applies to most 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 the 112th Congress, the House unanimously passed H.R 1864, the Mobile Workforce State Income Tax Simplification Act. This legislation, which unfortunately never received Senate consideration, would have prevented states from requiring income tax filing or withholding from workers unless they reside or work in a given state for more than 30 days in a calendar year. This common sense criterion would prohibit unfair income tax filing requirements on non-residents and at its core is the wise counsel of the physical presence standard.

Another example of the importance of physical presence in tax policy is H.R. 2992, Chairman Goodlatte's Business Activity Tax Simplification Act. He has for years championed this important legislation, on which this committee held a hearing just two weeks ago, that would strengthen definitions of what constitutes a physical presence in direct response to overly-aggressive state efforts to assert tax authority over companies that do not have substantial nexus.

The MFA would erase the physical presence standard for remote retail sales, while ostensibly maintaining it for brick-and-mortar sales. The result, as outlined further in this testimony, would be an abandonment of limits on taxing powers that have served our federal system so well for decades, even centuries.

In fact, S. 743's language makes very clear how it would place the physical presence standard on the slippery slope to extinction. Section 3 of the bill reads like an admission that the legislation could have grave implications for taxpayers, insisting that it is not intended to affect tax, nexus or licensing and regulatory requirements, respectively, in subsections (a) – (c). In other words, the bill's authors promise that its language strips away the physical presence protection *only* for sales taxes and not for other levies and that it doesn't open businesses up to regulatory interventions in states where they have no physical presence.

While it is true that the bill's plain language does not empower states to untether other policies from the physical presence protection, the bill does establish a precedent that aggressive states could use to expand their reach. If states were empowered to enforce their *sales* tax obligations on non-resident businesses, it seems just a matter of time before some will attempt to enforce *other* tax obligations on non-resident businesses, as well.

For example, if Utah-based Overstock.com does 15 percent of its sales to California residents, the state might well argue that it is entitled to impose California business tax obligations on an equivalent share of Overstock's profits. A state like New York could assert that, if non-resident businesses must collect sales tax for items sold to New Yorkers, they also should comply with New York consumer product and labor regulations for items sold to New Yorkers. The slope toward state power unbounded by geography the MFA would create is slippery indeed.

Marketplace Fairness Act Would Yield "Unlevel" Playing Field

MFA proponents argue their bill is intended to "level the playing field" between brick-and-mortar and remote retailers. In reality, it would do the opposite. While the legislation would require sellers to collect sales tax on every remote sale, it would do so with a different and unequivocally harsher set of rules than exist for brick-and-mortar sales.

Passage of the MFA would mean states could strong-arm remote sellers into complying with the more than 9,600 separate sales tax rates that exist across the country, not to mention the 46 states with sales taxes that can issue their own unique set of edicts and definitions.[1] S. 743 would concoct a "destination-based" sourcing regime that compels sales tax collection based on the location of its customer. An online business would have no choice but to quiz each and every customer on their residence, decipher the appropriate rates for their locality and remit what is collected to a distant tax agency.

[1] Tax Foundation, "Sales Tax Rates in Major U.S. Cities," Accessed March 2, 2014. http://taxfoundation.org/article/sales-tax-rates-major-us-cities

But 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 quizzed about their residence and then charged the prevailing rate in that locality. That's because brick-and-mortar retailers effectively operate on an "origin-based" sourcing rule, one that collects tax based upon the location of the business rather than the location of 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 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 charges the prevailing sales tax where it is located to all of its customers, regardless of their eventual destinations. The MFA would deny that administrative convenience to remote retailers by pressing them into a cross-examination process for each and every customer.

S. 743 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 MFA essentially acknowledges its imposition of major expenses and complexity by including an exemption for businesses that have less than $1 million of annual remote sales. This provision makes clear that even sponsors and supporters feel compliance would exact an unbearable toll on small sellers.

Unfortunately, S. 743's paltry exemption level (by comparison, the Small Business Administration threshold for defining a small business is $30 million in sales) would do little to ease the suffering of smaller businesses, which would face greater relative competitive disadvantages as a result of the bill. A PricewaterhouseCoopers study found that businesses with between $1 million and $10 million in sales would face compliance costs nearly 2.5 times larger than those endured by firms with more than $10 million in sales.[2] The smaller the business, the greater the proportion of sales siphoned off just to navigate this maze of extremely complicated sales taxes.

Industry data suggests the specialty retail sector (which includes businesses like Bed, Bath & Beyond and Amazon.com) enjoys an average net profit margin of just 4 percent[3], while catalog and mail-order retailers (which include eBay and Overstock.com) average 2 percent[4]. A hypothetical business with $1 million of remote sales would earn $20,000 to $40,000 of profits on those sales. A business with a $20,000 operating margin would be hard-pressed to comply with rates from thousands of tax jurisdictions without severe damage to their business.

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[2] PriceWaterhouseCoopers, "Retail Sales Tax Compliance Costs: A National Estimate," Accessed March 2, 2014. http://netchoice.org/wp-content/uploads/cost-of-collection-study-sstp.pdf

[3] Yahoo! Finance, "Industry Center – Specialty Retail," Accessed March 2, 2014. http://biz.yahoo.com/ic/745.html

[4] Yahoo! Finance, "Industry Center – Catalog & Mail Order Houses," Accessed March 2, 2014. http://biz.yahoo.com/ic/739.html

Some companies would collapse under the weight of these compliance loads, and others would either have to raise prices substantially (which is difficult to impossible to do in any competitive market) or find other ways to cut costs, such as through layoffs, in order to make ends meet. Congress has the duty and authority to prevent states from enacting policies that significantly harm interstate commerce. Paradoxically, S. 743, would encourage such damage at an especially fragile time for our economy.

Tax Simplification Efforts Have Largely Failed

Much of the movement behind the MFA has been justified by the argument that sales tax codes are being simplified 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 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. Former Forbes.com writer Josh Barro discussed a bulletin from the Wisconsin Department of Revenue seeking to clarify the tax treatment of ice cream cake.[5]

> 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 offers a vivid illustration of the challenge of tax complexity: the exceedingly difficult work of establishing how a given item is defined. Different localities have different answers, each of which may yield different tax obligations. MFA proponents claim 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 math has existed for decades but the ice cream cake conundrum can't be solved with software alone.

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[5] Forbes.com, "Want to Sell an Ice Cream Cake? Just Fill Out These Simple Forms," Accessed March 2, 2014. http://www.forbes.com/sites/joshbarro/2012/04/03/want-to-sell-an-ice-cream-cake-just-fill-out-these-simple-forms/

Marketplace Fairness Act Violates All of Chairman Goodlatte's Principles

Last year, Chairman Goodlatte released a commendable list of seven important principles to guide any future action on Internet sales taxation: tax relief, tech neutrality, no regulation without representation, simplicity, tax competition, states' rights and privacy rights. Sadly, the MFA violates every one of these principles.

	Goodlatte Principle	Marketplace Fairness Act
1.	Tax relief - Using the Internet should not create new or discriminatory taxes not faced in the offline world. Nor should any fresh precedent be created for other areas of interstate taxation by states.	Businesses would face new and more burdensome tax collection requirements for online sales. MFA would constitute precedent for undermining or eliminating the physical presence standard in other areas of taxation and regulation.
2.	Tech Neutrality – Brick & mortar, online and brick & click businesses should on equal footing. The sales tax compliance burden on online Internet sellers should not be less, but neither should it be greater than that on similarly situated offline businesses.	MFA would deliberately advantage brick-and-mortar over remote sales by allowing in-person transactions to have tax collected under dramatically simpler origin-sourcing rule, while online transactions would have tax collected under an extremely complex destination-sourcing rule.
3.	No Regulation Without Representation – Those who would bear state taxation, regulation and compliance burdens should have direct recourse to protest unfair, unwise or discriminatory rates and enforcement.	Under MFA, businesses would be subject to regulation, audit and enforcement actions in states where they have no presence whatsoever, constituting regulation without representation.
4.	Simplicity – Governments should not stifle businesses by shifting onerous compliance requirements onto them; laws should be so simple and compliance so inexpensive and reliable as to render a small business exemption unnecessary.	MFA entails enormous complexity, forcing businesses to comply with thousands of complex and ever-changing sales tax rates. Its small business exemption, though paltry, is evidence that sponsors recognize the burden and wish to protect smaller operations from its ravages.
5.	Tax Competition – Governments should be encouraged to compete with one another to keep tax rates low and American businesses should not be disadvantaged vis-a-vis their foreign competitors.	Because it would allow states to target non-resident businesses, MFA encourages higher rates that can be extracted from entities with no recourse to challenge or lower them.
6.	States' Rights – States should be sovereign within their physical boundaries. In addition, the federal government should not mandate that states impose any sales tax compliance burdens.	MFA obliterates the concept of state powers limited by geographical borders, allowing them to extend their tax authority into any state in the nation, including those without sales taxes.

7. Privacy Rights – Sensitive customer data must be protected.	MFA requires exchanging enormous amounts of personal data to enable auditing and enforcement, raising the prospect of privacy violations and leaks of sensitive information.

Where MFA Fails, Origin Sourcing Succeeds

The MFA guts an important limiting principle that a state may tax and audit only those entities within its borders; imposes an unlevel playing field for brick-and-mortar and remote sales; creates substantial compliance and interstate commerce burdens; and relies on the flawed notion that software can allow for easy compliance with thousands of ever-changing sales tax codes nationwide.

An origin-sourcing rule, however, affirms the physical presence standard by clarifying that states can only enforce tax collection and audit obligations on resident businesses, imposes precisely the same collection standard on remote sales as it does on brick-and-mortar sales, entails minimal compliance obligations and eliminates the need for complex software integration by specifying that collection and remittance for a given business will only be for the tax authorities in that locality.

Comparing a federal origin sourcing rule to the seven Goodlatte principles yields a very different story indeed.

Goodlatte Principle	Origin Sourcing
1. Tax relief - Using the Internet should not create new or discriminatory taxes not faced in the offline world. Nor should any fresh precedent be created for other areas of interstate taxation by states.	Businesses would face the same collection standard for all sales, whether in-person, via Internet or mail-order. Physical presence standard would be affirmed as the appropriate rubric for imposing tax-collection obligations.
2. Tech Neutrality – Brick & mortar, online and brick & click businesses should on equal footing. The sales tax compliance burden on online Internet sellers should not be less, but neither should it be greater than that on similarly situated offline businesses.	Origin sourcing would not punish a business for availing itself of the Internet with a more burdensome collection standard. Instead, it would ensure that all sales are treated precisely the same for tax-collection purposes, leveling the playing field between technologies and business models.
3. No Regulation Without Representation – Those who would bear state taxation, regulation and compliance burdens should have direct recourse to protest unfair, unwise or discriminatory rates and enforcement.	Because it affirms the physical presence standard, origin sourcing would ensure that no business faced regulation without representation. The only tax authorities to which a business would be liable would be those for its physical location, where they have administrative and political recourse.

4. Simplicity – Governments should not stifle businesses by shifting onerous compliance requirements onto them; laws should be so simple and compliance so inexpensive and reliable as to render a small business exemption unnecessary.	Origin sourcing is radically simple, allowing most businesses to seamlessly comply simply by running remote sales through the same system as in-person sales. The burden of doing so would be so minimal that a small business exemption would not be necessary.
5. Tax Competition – Governments should be encouraged to compete with one another to keep tax rates low and American businesses should not be disadvantaged vis-a-vis their foreign competitors.	Origin sourcing provides for healthy tax competition between states, encouraging them to compete with one another to create and maintain attractive climates for business location.
6. States' Rights – States should be sovereign within their physical boundaries. In addition, the federal government should not mandate that states impose any sales tax compliance burdens.	Origin sourcing affirms appropriate limits on state taxing power, ensuring that only the home state has authority to enforce tax collection obligations on its businesses.
7. Privacy Rights – Sensitive customer data must be protected.	Origin sourcing entails fewer exchanges of sensitive information with fewer entities, since each business would deal just with its local tax authorities, not dozens across the country where data might become compromised.

How Origin Sourcing Rules Work

As mentioned, an origin sourcing rule requires collection of applicable sales tax based on the physical location of the seller, as opposed to requiring collection based on the physical location of the buyer.

Imagine that a Texas resident makes a purchase over the Internet from a single-location Massachusetts-based retailer. Because the business does not have a physical presence in Texas, current law does not require any sales tax be collected on the item (though the buyer will owe use tax directly to Texas). This is relatively simple for the business to administer, since their lack of storefront, distribution or staff in Texas makes clear they have no substantial nexus with the state that would trigger any collection requirement. It does, however, raise concerns for some policymakers, since the use tax the individual owes is almost certainly not going to be paid.

Under a destination sourcing rule, such as that effectively countenanced by the MFA, the Massachusetts business would be required to quiz the customer as to their residence, look up and accurately apply the appropriate Texas tax rate for the item, and then remit the collected dollars to the appropriate tax authority, despite the fact that they have no presence themselves in the Lone Star State. It would also open them up to audit and enforcement actions from that distant tax authority.

Under an origin-sourcing rule, the Massachusetts company would simply collect tax based on the Bay State jurisdiction where their business is located, regardless of where the customer resides. As a result, the seller need only be familiar with and accountable to the rules and enforcement actions of the jurisdiction in which they're located.

Where Origin Sourcing Already Applies

Origin sourcing is not at all a novel concept. In fact, it governs the vast majority of retail sales today. Virtually all state laws are structured so that collection on in-person sales effectively mimics an origin-sourcing rule. As previously mentioned, they do this by assuming that the "destination" of the good for purposes of sourcing is the counter at which the customer receives it. Brick and mortar retail businesses are not asked to interrogate their customers to determine whether they reside in a different state or locality. The simplicity inherent in this rule means that there are no hoops to jump through to determine in which of America's many taxing jurisdictions the customer resides and how to apply its unique code to the sale.

Though it surprises some to hear, this structure governs more than than nine out of every 10 sales made from businesses to consumers in the United States today. Despite popular perception of Web dominance, U.S. Census Bureau data shows that only 6 percent of all sales are currently transacted over the Internet.[6] Mail-order sales represent an even smaller share. Though the segment is clearly growing at a rapid rate, the reality is that retail is still predominantly conducted in stores across the country and that will remain the case for years, perhaps decades, to come.

In addition to all brick-and-mortar retail sales, origin sourcing prevails to one degree or another for *intrastate* remote sales in at least 17 states that contain more than half of America's population: Arkansas, Arizona, California, Iowa, Illinois, Missouri, North Carolina, Ohio, Oklahoma, Pennsylvania, Rhode Island, Tennessee, Texas, Utah, Virginia, and Washington. In each of these jurisdictions, most remote transactions completed between a resident and a business located in the same state will have tax collected based on the seller's location, not the buyer's.

In other words, origin sourcing is already the overwhelmingly dominant mode of sales tax collection in the United States, covering substantially all transactions conducted in physical retail outlets (which themselves comprise more 90 percent of total retail sales) as well as intrastate remote retail sales for roughly half the country. As such, the "universe" of business-to-consumer sales for which destination sourcing reigns is really quite small. In seeking to expand its use to cover all remote interstate sales, the MFA relies on an outmoded collection standard that is unworkable on a national scale.

The United States is by no means alone in its extensive reliance on origin sourcing. The European Union also takes advantage of its simplicity by employing it for value-added tax collection on business-to-consumer services performed across member-country borders, in

[6] U.S. Census Bureau, "Quarterly Retail E-Commerce Sales, 4th Quarter 2013," Accessed March 2, 2014. http://www.census.gov/retail/mrts/www/data/pdf/ec_current.pdf

order to ease the burden of collection and remittance obligations. The same is true of tangible goods sold from business-to-consumer, below certain sales thresholds.[7] The American Enterprise Institute's Michael Greve covers the E.U.'s grappling with cross border taxation policy extensively in his brilliant book, *Sell Globally, Tax Locally.*[8]

Interestingly, E.U. countries use destination sourcing as something of a protective measure against non-E.U. countries that sell services to consumers that reside in the union. A U.S. business selling to a consumer in the European Union would be required to collect and remit the value-added tax on a complex destination sourcing rule, forcing them to comply with dozens of different rates, while an E.U. business selling to the very same consumer would simply collect the rate for its home country. This makes collection simpler for E.U. businesses, turning destination sourcing into a sort of protectionist cudgel used against foreign competitors.

The Federal Role in Origin Sourcing

If this committee or this Congress considers any changes to federal law relating to Internet sales tax collection, I believe it should do one simple thing: pass legislation stating clearly that an origin-sourcing rule is the only permissible standard for state taxation of interstate remote sales. All other methods, including the destination-sourcing scheme embodied in the MFA, would be effectively pre-empted.

Structured in such a way, a federal origin-sourcing rule contemplates a role for Congress not at all dissimilar to the one laid out in the Marketplace Fairness Act, though the policies themselves are of course quite different. What MFA does is set out the conditions under which states may assert authority to tax remote interstate sales, as well as the conditions under which they may *not* assert that authority.

The MFA's federal intervention would empower states to assert their tax power on remote interstate sales if they become members of the Streamlined Sales and Use Tax Agreement or if they abide by a separate set of minimum simplifications. However, it also sets out conditions under which states would *not* be permitted to do so, indicating that taxation of remote interstate sales would be impermissible if they failed to meet either of the aforementioned standards. Even if they do indeed meet one of the standards, taxation of businesses with remote sales less than $1 million would be impermissible in any case.

An origin-sourcing rule would actually be much less prescriptive for states than would MFA. It would simply say that states may only tax interstate remote sales if they do so on an origin-sourced basis. If a state meets that standard, it may apply tax to interstate transactions, but it would be under no other obligations to the federal government beyond existing laws and regulations.

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[7] European Commission Taxation and Customs Union, "Where to tax?," Accessed March 2, 2014. http://ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/vat_on_services/

[8] Michael Greve, *Sell Globally, Tax Locally* (Washington, DC: The AEI Press, 2003)

For example, states would be perfectly free to define a sales tax base as wide or narrow as they please. Similarly, they would be perfectly free to set sales tax rates as high or low as they please, including the freedom to choose not to have a sales tax at all. In fact, states could decide to use destination sourcing for *intrastate* sales if they felt it was best. The only constraint on state tax power in a federal origin sourcing rule would be on states seeking to assert tax authority over interstate remote sales, which would have to operate on an origin basis in order to avoid the compliance and interstate commerce nightmare of a destination regime for such transactions.

Importantly, any federal legislation specifying origin sourcing as the appropriate standard should establish some baseline protections against manipulation or deception from businesses that might seek to avoid tax collection. For example, the language should establish basic definitions of origin that prevent companies from setting up shell operations.

Guidance can be found in states where origin sourcing exists for intrastate remote sales. Virginia specifies that the origin of an item is the "location at which the order was first taken[9]," while Texas establishes origin at the location from which the item is shipped[10]. Congress might consider blending these approaches or perhaps seeking input from other areas of tax law, like business activity taxes, which establish clear rules for defining origin.

A federal rule should also specify that items on which sales tax has been collected, regardless of origin, may not also be subjected to duplicative use tax. It is highly unlikely that states would choose to aggressively enforce use taxes in such a way given that the failures of that system have led to this very hearing, but federal guidance would be helpful in preventing potential abuses. The only reason a state might attempt to employ a redundant use tax is as a form of protectionism against out-of-state businesses and products and thus Congress has a clear role in pre-empting such behavior.

It also may be necessary for an origin-sourcing law to specify that legal proceedings related to the matter be handled in federal court, as opposed to on the state level.

Why the Case Against Origin Sourcing is Weak

I believe strongly that origin sourcing is the appropriate frame for Internet sales taxation, but it is not without its detractors. Some big-box retailers, in particular, have waged a subtle lobbying battle against it for months. Though they mount occasionally vigorous opposition to the concept, their arguments simply don't hold up to scrutiny.

The first and most important defense against attacks on origin sourcing is to point to the fact that it already applies to the overwhelming majority of retail sales in the country, including substantially all brick-and-mortar sales. While no system is perfect, origin sourcing has served brick-and-mortar retail just fine for decades.

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[9] Virginia Department of Taxation, "Guidelines for the Retail Sales and Use Tax Changes Enacted in the 2013 General Assembly Session," Accessed March 2, 2014. http://goo.gl/X0IvzC

[10] Texas Comptroller of Public Accounts, "Guidelines for Collecting Local Sales and Use Tax," Accessed March 2, 2014. http://window.state.tx.us/taxinfo/taxpubs/tx94_105.pdf

In other words, origin sourcing is either inherently problematic or it's not. If it is, then intellectual consistency dictates that we must scrap virtually the entire retail sales tax collection structure in place today in favor of a destination rule requiring retailers to quiz their customers and comply with far-away tax authorities. If it's not, opponents must articulate why it works perfectly well for in-person sales but somehow won't for remote sales.

Race to the Bottom

Opponents of origin sourcing claim it would set off a "race to the bottom," whereby businesses would rush to locate in non-sales tax states (or foreign countries) in order to avoid having to collect. This is unlikely for a host of reasons. First, sales tax collection is but one burden faced by a business. While taxes clearly have strong influence on both individual and firm behavior, any company must weigh its sales tax burden against other levies, like income and property taxes. In addition, it must consider factors like a quality labor pool, access to transportation infrastructure, proximity to suppliers and many others. Any location decision is likely to balance all of the aforementioned factors.

Consider a business in the Pacific Northwest. It could decide between two very different tax systems in Washington state, which has no income tax and high sales taxes in some areas, and Oregon, which has no sales tax and high income taxes. It is not at all obvious that every rational firm would choose to locate in Oregon, given the choice, because their business model may benefit more from Washington's climate.

In addition, there's nothing stopping the race to the bottom today. An online retailer wishing to avoid collection obligations under current law has the same incentive today to locate in a non-sales tax state as they would under a federal origin sourcing rule. It could escape collection in other states without triggering any in its new home state, since the one place where it would have physical presence has no sales tax at all. In reality, however, relatively few businesses have done so, precisely because location decisions are much more complicated.

Furthermore, to the extent that businesses *do* decide to make location decisions on the basis of beneficial tax climates, that's a good thing. Consumers and taxpayers benefit from states competing with one another to attract businesses, jobs and economic activity with modest and comprehensible tax burdens. Congress should encourage tax competition because it disciplines state budgeting and allows the "laboratories of democracy" concept to flourish.

In my view, the much more likely scenario than the wholesale flight of retailers to New Hampshire or Montana is that sales tax issues could affect location decisions on the margin in a given region. For example, in the Washington, D.C, metro area, one might see businesses deciding to locate in relatively lower-tax Virginia over Maryland.

Taxation Without Representation

A criticism often heard of origin sourcing is that it amounts to taxation without representation. This stems from a fundamental confusion about who, exactly, bears the burden of sales taxes.

Though the levy is ostensibly tied to an individual's purchase and theoretically gets passed on to the consumer, the reality is that businesses are, for all intents and purposes, the "taxpayer" as it relates to sales tax.

Consider what happens if a state believes there is a shortfall in sales tax collections. In such a case, that state will not come to the consumer to recoup the dollars, it will come to the seller. The business is legally liable for all sales tax collection, regardless of whether or not they collected enough from their customers, and any shortfall would be adjudicated through an audit on and be paid for by said business. So while it's true that the *economic* incidence of sales tax is borne by the individual, the *legal* incidence is borne entirely by businesses.

In fact, in many places, the sales tax is defined as a "business privilege" or "transaction privilege" tax. Arizona's Department of Revenue describes their sales tax thusly:

> 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.[11]

The sales tax is a tax administered by business in much the same way corporate income tax is. In both cases, the economic burden is borne entirely by individuals. With sales tax, that economic burden is passed on directly when an item is paid for. With corporate taxes, the burden manifests itself either in the form of higher prices, lower wages or fewer jobs for workers or reduced returns for shareholders. And in both cases, the legal incidence of the tax is borne entirely by the business, on which all requirements for compliance fall.

States' Rights

Another common refrain is that origin sourcing violates fundamental concepts of states' rights by undermining their ability to tax purchases made by their residents. This, too, is rooted in the aforementioned misunderstanding of who the "taxpayer" really is. Though a state's resident may make a purchase, it is *another* state's business that has the legal obligation to collect and remit the sales tax and be subject to audit and enforcement actions.

What this criticism attempts to defend is the notion that states should have the unfettered right to tax businesses in any state across the country. In effect, it yearns for the days of the Articles of Confederation, when states were empowered to enact deleterious protectionism in the form of unbounded tax and regulatory authority. The result of that failed experiment was a new federal charter which explicitly empowered the federal government to head off such actions.

The Commerce Clause of the Constitution and subsequent jurisprudence gives Congress the clear power to pre-empt state actions that impede the flow of interstate commerce. Though

[11] State of Arizona Department of Revenue, "Transaction Privilege Tax Licensing," Accessed March 2, 2014. http://www.azdor.gov/Business/TransactionPrivilegeTax.aspx

Congress must take care to exercise this power judiciously, it is my view that an origin-sourcing rule is fully consistent with its precepts. A destination-sourcing rule, such as that embodied in the MFA, would entail such disruption and cost to interstate commerce that Congress would be justified in pre-empting such rules by passing a law establishing origin sourcing as the only acceptable means of tax collection on interstate remote sales.

A perfect example of Congress exercising this power is the Internet Tax Freedom Act. Originally passed in 1998 and most recently renewed by unanimous votes in both the House and Senate in 2007, this legislation acts as a federal prohibition on any state or local taxation of Internet access or imposition of discriminatory Internet-only taxes, such as a levy on bandwidth. Congress recognized the danger inherent in states singling out the Internet for harsh tax treatment and moved to foreclose their legal authority to do so, lest such efforts stifle the flourishing of a technology that has since provided incalculable benefits to the economy and standards of living.

A more recent example is the Wireless Tax Fairness Act, H.R. 2309 in this current Congress. This legislation has been sponsored by 219 Members, including many on this committee, and passed the House by a voice vote in 2011. It would establish a five-year moratorium on state imposition of discriminatory tax rates on wireless phone and data services. This too is a federal pre-emption of state law in service of the higher goal of preventing harm to interstate commerce, as few markets are more interstate in nature than wireless service.

States' rights are important and all-too-often trampled by an overzealous federal government. They should indeed be sovereign entities free of unnecessary federal meddling. But the Constitution made clear that their rights, especially as it relates to taxation, end at the border and an origin-sourcing rule would underscore that protection.

Conclusion

S. 743, 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 burdening interstate commerce by foisting unworkable schemes on remote sellers. Simply treating remote sales in the same way that we already treat brick-and-mortar sales would level the playing field in an honest way.

While the policy points away from the MFA and in the direction of origin sourcing, it is worth mentioning the politics of the issue do much the same. Last year, the R Street Institute joined with the National Taxpayers Union to commission a poll testing public attitudes on Internet sales tax issues, where we found strong and surprisingly widespread 57 percent opposition to an MFA-like scheme.[12]

[12] R Street Institute and National Taxpayers Union, "Is Congress Listening? The Peril of Ignoring Public Opinion on the Internet Sales Tax Issue," Accessed March 2, 2014. http://www.rstreet.org/wp-content/uploads/2013/09/Internet-Sales-Tax-Is-Congress-Listening.pdf

Republicans were opposed by a 39-point margin, independents by a 22-point margin, and even Democrats by a four-point margin. Virtually every demographic, region, income level and vote behavior showed strong margins of dislike for the plan. And it wasn't just knee-jerk reaction to the "T" word; by better than a 3-to-1 margin, respondents correctly identified current law and by roughly 2-to-1 margins, they gravitated toward anti-MFA arguments when put head-to-head in a neutral manner against pro-MFA statements.

No Congress should govern by poll alone, but this data proves that not only is a destination-sourcing scheme like the MFA bad policy, it is profoundly bad politics as well. That should send a strong message to this committee that America is engaged on this issue and that only something like an origin-sourcing rule to truly level the playing field can pass muster with them. Thank you for the opportunity to submit this testimony today and I welcome any questions from members.

Mr. GOODLATTE. Thank you, Mr. Moylan.
Mr. Cox, welcome back to the House.

TESTIMONY OF THE HONORABLE CHRIS COX, COUNSEL, NETCHOICE, PARTNER, BINGHAM McCUTCHEN LLP

Mr. COX. Thank you very much, Mr. Chairman, Ranking Member Conyers, Members of the Committee. I am here today as counsel to NetChoice, which is a coalition of leading e-commerce and online businesses. And as you know, in the past it has been my privilege to work with many Members of this Committee on important internet legislation, including the Internet Tax Freedom Act, which this Committee under both Republican and Democratic leadership has repeatedly voted to extend.

When I first introduced the Internet Tax Freedom Act in the late 1990's, it was with concern that the very nature of the internet exposes it uniquely to multiple and discriminatory taxation. Sixteen years after its enactment, we now know that the Internet Tax Freedom Act has worked in preventing those kinds of discriminatory burdens. On behalf of NetChoice and all of our members, we hope that you soon send to the President legislation to permanently extend the Internet Tax Freedom Act.

As you consider the much more difficult question of internet sales taxes, the basic principle of the Internet Tax Freedom Act should be your guide, this principle of non-discrimination, of not placing burdens on one form of commerce that does not exist on the other. And this Committee and your very excellent principles have listed that under the heading of tech neutrality. As explained by the Committee, "tech neutrality" means that the tax compliance burden on online sellers should be no more or no less than that on brick and mortar sellers.

MFA rather obviously fails this test. Were it to become law, a brick and mortar business would have to comply with the tax laws and filing requirements of the State where it is located. But the online business right next door immediately would have to comply with those laws and the laws of 45 other States. That is the very definition of discriminatory burden.

There is a better way. In your home State of Virginia, Mr. Chairman, many residents of D.C., of Delaware, and of Maryland shop at Pentagon City. And what happens when they go to a clothing store in Pentagon City? Does the store clerk ask the customer when she is buying a shirt, "What State are you from?" or "what county or what city are you from, so that I can charge the correct sales tax?" That is not what happens. We all know the answer. The store clerk charges the sales tax for Arlington, Virginia, independent of where the customer lives. That is the way it works all across America today in every State that has a sales tax.

And that is how the Pentagon City store owner and how brick and mortar store owners everywhere across the country are themselves protected from having to comply with 45 State laws all at once. Yet this is the same protection that would immediately be denied to online sellers if MFA were to become the law.

The way to level the playing field is to make sure that every business—brick and mortar or online—is required to do things the same way, to follow the same rules. And that is what we call home

rule. Under home rule, every business would continue to file monthly sales tax returns, continue to report taxes in the States where it is located. And it would continue to face sales tax audits in all of those States just as today. Congress can authorize this home rule arrangement by legislation approving a voluntary multistate compact. It is voluntary in support of the Committee's principle of States' rights.

Joining the compact, however, would be advantageous for States because they would immediately begin to receive sales tax revenue that today they do not get at all. Sales taxes on purchases by catalog or by internet would now have to be paid to the purchaser State for all the States that are in the compact. And we call this feature revenue return. The home rule and revenue return approach guarantees not only relative ease of tax collection and filing, but a single source of audit of remote sales.

So consider a small business. Once the State where it is located joins the compact, that State becomes the law's home jurisdiction. The home jurisdiction is then the single auditor for all sales into other States. Now, consider a bigger business with multiple locations in several States. The State where it has the most employees would typically become its home jurisdiction. And once again, that home jurisdiction then becomes the single auditor for all sales into other States where the business has no physical presence.

This overall approach of home rule and revenue return meets every one of the Committee's 7 principles. It is a way to level the playing field without undue burden, complexity, expense, and the unconstitutionality of MFA.

If I may, Mr. Chairman, may I close on a note of caution? You have called for alternatives to MFA, and NetChoice has been happy to comply. But if MFA were the only option, NetChoice would strongly prefer today's system. From the standpoint of a small business, MFA is fundamentally unfair. It erects intolerable new compliance burdens on e-commerce. And so, we applaud your efforts to take care that things are not made worse in the name of making them better.

I look forward to your questions.

[The prepared statement of Mr. Cox follows:]

Statement of Christopher Cox

on behalf of

NetChoice

Testimony before the

United States House of Representatives Committee on the Judiciary

Hearing on:

Exploring Alternative Solutions on the Internet Sales Tax Issue

March 12, 2014

Chairman Goodlatte, Ranking Member Conyers, and members of the Committee:

Thank you for holding a hearing on *Exploring Alternative Solutions on the Internet Sales Tax Issue*. As you know, I have worked with many of you on this Committee on Internet legislation over the last 20 years, and in particular the Internet Tax Freedom Act, which I co-authored with Sen. Ron Wyden in 1998.

I serve as tax policy advisor to NetChoice, a coalition of leading e-commerce and online companies promoting the value, convenience, and choice of Internet business models.

NetChoice has been deeply engaged on Internet tax issues for 14 years, including testimony before this committee and policy debates in the Wall Street Journal, on CNBC, CSPAN, CNN, and PBS. Since 2004, we have participated in meetings of the Streamlined Sales Tax Project (SSTP), a long-term effort to simplify state sales tax systems in response to the *Quill* ruling of the U.S. Supreme Court.

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

The yardstick for measuring the strength or weakness of various approaches to taxing remote transactions on the Internet must be the *Basic Principles on Remote Soles Taxes* put forth by this Committee. We fully support these common-sense Principles, which are necessary to guarantee fundamental fairness to all marketplace participants. This hearing is focused on exploring alternatives to the Senate-passed Marketplace Fairness Act (MFA), and it should be clearly stated before moving to discussion of those alternatives that the MFA itself fails to satisfy any of the Principles. Achieving every one of the Principles is a challenge even when one starts from a blank slate. Attempting to contort and stretch the pre-conceived MFA approach to fit the Principles is an undertaking worthy of Procrustes. But is ultimately impossible.

If one begins with the Principles as the blueprint, the task – while still difficult – becomes more rational. The Principles themselves suggest the way forward. Building on the fundamental concepts in the Principles, we have conceptualized an alternative to the fundamentally flawed MFA that enables states to collect sales tax on remote transactions. This approach, best described as *Home Rule & Revenue Return,* has three main characteristics:

1. **Fairness.** Unlike the MFA, our alternative imposes the same tax compliance burdens on all retailers, whether brick-and-mortar, online, or catalog.

2. **Simplicity.** In contrast to the complexity and costs created by MFA that requires expensive and potentially flawed software integration, our alternative is workable for the smallest of businesses. Brick-and-mortar and e-businesses alike, no matter their size, would use the tax rates and rules of their home state—just like they do today.

3. **States' Rights.** Serious constitutional problems arise when states attempt to impose tax collection and compliance burdens on out-of-state businesses. This is the central design flaw of the MFA. Our proposed alternative is built on the constitutional principle that each state is sovereign over the regulation and taxation of businesses in that state. Each state will have the choice whether to join a multi-state compact, pursuant to which taxes on out-of-state sales would be collected.

The Judiciary Committee has a unique role, given your responsibilities to protect interstate commerce, and to protect states' rights to make their own tax policies within a federal system. Successfully achieving both of these objectives is central to resolving the debate over Internet sales tax collection. To understand how these potentially conflicting objectives can be reconciled begins with the answers to three key questions:

- *Why don't online and catalog retailers pay sales tax to every state?*
- *Haven't states simplified their sales tax systems through the SSTP initiative?*
- *Isn't this debate fundamentally about "fairness"?*

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

The editors of the *Wall Street Journal* asked NetChoice to provide the opposing side in a debate over internet sales tax. Our published article began with this question and answer:

> 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 I of the Constitution. It is designed for the very purpose of preventing individual states from impeding commerce among the states. The Commerce Clause was necessary to restrain states that had been imposing taxes, duties, and other trade barriers on each other in ways that favored in-state businesses and unfairly burdened out-of-state businesses. It is just as necessary now as it was when written.

During the 1960s, some state tax collectors attempted to force out-of-state catalog retailers to collect in-state sales taxes. The U.S. Supreme Court, relying on the Commerce Clause, held that states cannot impose taxes on out-of-state businesses "whose only connection with customers in the State is by common carrier or the United States mail."[2]

In 1992, the Supreme Court revisited the issue of remote taxation, this time in the case of an office products catalog seller, Quill.[3] In *Quill*, the Supreme Court was not moved by the state's argument that computer technology created the necessary simplification. While acknowledging the lower court's finding that advances in computer technology had eased the burdens of tax collection, the Court still found the requirement of tax collection unduly burdensome.[4] Observing the patchwork of rates and rules for several thousand sales tax jurisdictions, the Court again held that requiring out-of-state companies to pay sales taxes would place an unreasonable burden on interstate commerce.[5]

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

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

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

[4] *Id.* at 313.

[5] Moreover, *Quill* was not concerned with "fairness" to individual tax collecting states, as some have argued, but with the burden on interstate commerce that results from multiple tax collection and compliance burdens. "[T]he Commerce Clause and its nexus requirement," the Court said, "are informed

Quill has served to protect local businesses that maintain websites from overbearing tax compliance burdens imposed by scores of foreign states where the business has no physical presence. At the same time, it requires every business, large or small, to collect and report sales tax in the same way in every state where the business does have a physical presence.

Understanding why the *Quill* standard exists – to protect local businesses engaged in out-of-state commerce from the burdens of multiple and discriminatory taxation – is essential to the consideration of any alternative approach.

Haven't states simplified their sales tax systems through their SSTP initiative?

In 1998 when Congress enacted, and President Bill Clinton signed, the Internet Tax Freedom Act, we deliberately chose not to exercise the legislative power under the so-called "dormant Commerce Clause" to authorize the states to impose their sales tax collection and compliance burdens on out-of-state retailers. Instead, the law established a Commission to study those and related issues. The transmittal of the final report of the Advisory Commission on Electronic Commerce in April 2000 recommended to Congress as follows:

> "Place the burden *on states to simplify* their own labyrinthine telecommunications tax systems as well as sales and use tax systems to ease burdens on interstate commerce. Radical simplification will be necessary in the New Economy if small and medium-sized businesses are to succeed."[6]

Thus began the effort that became the Streamlined Sales Tax Project (SSTP). Several individuals who were members of the Advisory Commission supported the effort. Its purpose was to create a sufficiently simple nationwide system of sales and use tax rules, definitions, audit authorities, filing requirements, and compliance regimes that could persuade Congress to exercise its power under the dormant Commerce Clause. The idea was that a simple one-size-fits-all system of uniform sales tax rules would remove the burden of what the Supreme Court called "a virtual welter of complicated obligations,"[7] inspiring Congress to authorize each state to force its tax compliance obligations on sellers in every other state.

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not so much by concerns about fairness for the individual [state] as by structural concerns about the effects of state regulation on the national economy."

[6] Letter to Congress from Advisory Commission on Electronic Commerce (Apr. 2000) (emphasis added).

[7] *See Quill, supra,* n.3.

NetChoice has long been a supporter of the effort to streamline and simplify state sales taxes. But thus far, the SSTP has failed to come even close to its stated objective. Despite a decade of trying, the actual simplifications achieved by the SSTP are few – and not nearly sufficient to justify Congress abandoning its role in protecting interstate commerce. Unfortunately, for the SSTP simplification has become just a slogan – not a standard.

The SSTP originally sought one tax rate per state, which would represent true simplification. Too many states were unwilling to do this, so the SSTP simply abandoned the effort. The SSTP's "simplification" now accommodates over 9,600 local jurisdictions,[8] each with its own tax rates and sales tax holidays. That is actually a substantial *increase* from the 7,800 jurisdictions that existed at the time of *Quill*. And the number is still growing, making the U.S. a true outlier. The European Union has only 27 jurisdictions for its Value Added Tax (VAT). India lets each state have but a single tax rate. We are the only country in the world in which sales taxes on national commerce are allowed to proliferate at the local government level.

The SSTP has abandoned too many of its original simplification requirements. For example, the SSTP no longer requires that retailers be compensated by foreign states for the cost of out-of-state compliance. It has all but eliminated the small seller exception. In an effort to attract states with origin sourcing, the SSTP abandoned a single sourcing rule and now allows for multiple sourcing schemes. To entice Massachusetts to join SSTP, the Governing Board allowed thresholds for certain clothing items, even though thresholds were one of the extreme complexities its founders pledged to eliminate.

Perhaps the most glaring sign of failure is that despite the SSTP's many concessions to each state's desired exceptions from the rule of simplicity, less than half of eligible states have joined. Today, the majority of states are not members of the Streamlined Sales and Use Tax Agreement (SSUTA). (There are only 22 full member states in the SSUTA).

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[8] "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.").

Isn't this debate fundamentally about "fairness"?

Yes.

The seven elements in this Committee's *Basic Principles on Remote Sales Taxes* all ultimately relate to fairness to the many stakeholders in this debate. The Committee's cardinal Principle, the first of the seven, is "Tax Relief" – in recognition of the fact that the interests of individual citizens are paramount to those of state governments and businesses. Under this heading the Committee has also warned against placing discriminatory tax compliance burdens on Internet retailers that brick-and-mortar businesses do not bear in the offline world.

The second Principle, "Tech Neutrality," is about horizontal equity. Brick-and-mortar, e-commerce, and "brick-and-click" businesses should all be on equal footing. Under this heading, the Committee explicitly states that tax *compliance* burdens should not be greater for any category of business.

The third Principle, "No Regulation Without Representation," recognizes that fairness dictates that those who would bear the tax, regulatory, and compliance burdens of a state should have the rights every citizen deserves to protest against unfairness in the imposition of those burdens. Citizens of a state have such recourse against their government, but out-of-state businesses normally do not.

The fourth Principle, "Simplicity," is aimed at ensuring fairness in state governments' treatment of small business. The Committee has recognized that when governments place onerous compliance requirements on businesses, the large ones can more easily comply than the small ones, which gives big business an unfair advantage. In this way the complexity of MFA discriminates against small business.

The fifth Principle is also about fairness to individual taxpayers. "Tax Competition," which exists when state governments are required to bear the costs as well as reap the benefits of high-tax policies, helps consumers.

The penultimate Principal, "States' Rights," is about fairness to each state government. In enunciating this Principle, the Committee recognized that no state can exercise its sovereignty beyond its borders without intruding on the sovereign prerogatives of another state. The Committee explicitly noted that were the federal government to mandate that states impose sales tax compliance burdens on out-of-state sellers, this principle of fairness to every state would be violated.

The final Principle, like all the others, is also focused on fairness. "Privacy Rights" must be at the forefront of any discussion of remote sales tax collection, because robbing consumers of their privacy in the name of tax collection is fundamentally unfair. Proposals to enforce a state's sales tax regime that entail keeping computer records of what each of us buys fail to satisfy this critical principle.

The existing system of sales tax collection fairly meets every one of the Principles -- with one exception. Similarly situated businesses do not collect taxes from out-of-state purchasers in the same way. But already today, *all* retailers -- large and small, brick-and-mortar, and e-commerce alike -- *do* collect sales tax in every state where that business is located. The current "physical presence" standard protects all businesses, large and small, from the unreasonable compliance burdens they would face if forced to collect for thousands of state and local tax jurisdictions within the United States. If this protective standard is to be changed in order to ensure that all businesses collect taxes from out-of-state purchasers, it must be accomplished in such a way that maintains this protection.

Even now, not only Internet retailers but brick-and-mortar retailers are protected by the physical presence standard. This standard guarantees that both brick-and-mortar and Internet businesses do not have to assume the burden of complying with the tax rules of all the states of residence of every one of their customers.

Imagine if a retail store on Main Street, which today collects sales tax for just the one jurisdiction where it is located, were required to collect and file tax according to the rules of the states of every one of its customers. Here's how NetChoice put it when the editors of *USA Today* invited us to give our view on MFA:

> Imagine if the cashiers handling your Black Friday checkouts asked to see your driver's license so they could look up sales tax rates and rules for the town where you live, then file returns and face tax audits for every state their customers came from. That sounds crazy, but it's exactly what the latest Internet sales tax bill would require for any business that sells through a catalog or website.[9]

Fundamental fairness is not just a good idea; it is a bedrock Constitutional principle. It is the basic test of due process. For this reason, proposals for states to exert their regulatory and

[9] Steve DelBianco, *Internet sales tax would level start-ups: Opposing view,* USA Today (Nov 28, 2013).

tax powers over out-of-state small businesses are not just bad ideas, but potentially unconstitutional.

The very same Supreme Court decision that confirmed the current "physical presence" standard under the Commerce Clause, *Quill Corp. v. North Dakota*, also held that a state's ability to impose tax collection burdens on an out-of-state business must comply with the Due Process Clause. That is because, the Court said, the Commerce Clause and the Due Process Clause "pose distinct limits on the taxing powers of the States." Moreover, "the two constitutional requirements differ fundamentally," because they "reflect different constitutional concerns."

While the Commerce Clause test is a bright line – does the business have a physical presence in the state? – the Due Process test is one of fundamental fairness. Are the business's contacts with a foreign state deep enough and substantial enough so that it would be fair to expect the owner of the business to have to personally appear in court in the foreign state? *Quill* makes it clear that if a state can require an out-of-state seller to collect its taxes and comply with its tax laws, it can also make that person appear in its courts to defend against lawsuits in that state. The Due Process test first set out in *International Shoe Co. v. Washington*[10] is the same for taxation, regulation, and personal jurisdiction.

Most would agree it is fundamentally unfair to force a local retailer, with only one place of business in a single state, to be subject to tax compliance burdens, including the requirement to appear in person to defend a lawsuit, in each of the 46 states that have sales taxes. If the same local retailer with only one place of business has a website, does this change the analysis?

Any small business that has a website is perforce exposed to the entire world. If the small business, let us say a bookseller, receives an order from a customer in North Dakota -- or even from a customer in Japan -- should fulfilling the order automatically subject it to direct regulation and taxation by that foreign government? Should this automatically make it subject to the regulation, taxation, and judicial reach of every U.S. jurisdiction?

It is virtually impossible for the bookseller in Vermont to have a website that is accessible everywhere except, say, North Dakota. Should the owner of a that small business in Vermont be required to refuse all Web sales from North Dakota, or else automatically be required to travel to North Dakota when commanded by that state to do so? That is the due

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[10] *Int'l Shoe Co. v. Washington*, 326 U.S. 310 (1945).

process question posed by the MFA and similar schemes. The Supreme Court in *Quill* effectively has answered it. To subject itself to the tax and regulatory jurisdiction of another state, a business must engage in "continuous and widespread solicitation of business" there. Only then will a business have "fair warning" that its activities will subject it "to the jurisdiction of a foreign sovereign."[11]

Mere maintenance of a website hardly amounts to "continuous and widespread solicitation." To argue that it does would require one to deem it "fair" for every business with a website to be regulated by every jurisdiction on Earth with access to the worldwide web. That is why, as former Solicitor General Paul Clement has written, "due process problems are particularly likely with respect to taxation of online sales." As he explains, "when a seller offers an item for sale on a website, customers from all 50 states may purchase that item –- whether or not the retailer takes conscious steps to target consumers from all 50 states." In the case of the local business that maintains a website, he wrote, "a court would likely find a due process violation" if a distant state sought to tax isolated transactions there. [12]

Today's approach to the taxation of Internet sales is consistent with due process. All retailers collect sales tax for every state where they choose to have a physical presence. Because a business can choose whether to open a store or send sales representatives to another state, it can be fairly said that the business has elected to subject itself to that state's laws, including those governing sales taxes. In return, the business can take advantage of state-provided benefits including roads and infrastructure, police and fire protection, utilities, etc..

Today, large national retail chains and big-box stores have retail outlets or distribution centers in almost every state, along with websites that let online customers arrange pickups and returns at their local stores. These businesses use many local public services wherever they have stores, and thereby reap benefits that out-of-state retailers do not. In return, these large, nationally active businesses are required to collect sales tax in the states where they are

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[11] *Quill, supra,* at 308 note 3.

[12] Paul D. Clement and Erin E. Murphy, *Constitutional Limits on the Ability of States to Tax Residents of Other States*, Bancroft PLLC (Nov. 13, 2012).

located. The out-of-state online retailers do not use local public services, and they do not have to collect sales taxes because they have no physical presence. This is fundamentally fair.[13]

Today, Amazon is adding distribution centers to enable faster delivery to customers around the country, which will require Amazon to collect sales tax *for two-thirds of all Americans by 2016*. [14] Like the big-box stores, Amazon would cut its tax compliance costs if states adopted even tiny steps toward simplification. More important, Amazon wins if MFA forces more small businesses to move their online sales onto Amazon's platform, where Amazon charges a 3% fee to collect sales tax, Amazon keeps up to 15% of every sales dollar, and Amazon sees 100% of the data on customer searches and purchases.

Other Constitutional Concerns with MFA and SSTP

In addition to the due process concerns raised by the MFA, the Senate-passed bill suffers from two other significant constitutional infirmities. First, the SSUTA is not an approvable interstate compact under the Compact Clause.[15] Second, the MFA purports to delegate significant federal power to the Governing Board of the SSTP, in violation of the Appointments Clause.[16]

The Compact Clause and its constitutional complement, the State Treaty Clause,[17] together ensure that a minority of states cannot band together to make national policy that directly affects all states. Interstate compacts are permissible where they treat discrete regional issues, such as boundary disputes, that directly affect the compacting states but not all others; but such compacts require congressional approval. On the other hand, purported state alliances that are national in scope and treat ongoing issues cannot be the subject of a

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[13] In *Quill*, the Supreme Court expressly considered and rejected the argument that it is unfair to give out-of-state sellers "a significant competitive advantage over local retailers" by permitting them to be exempt from foreign state sales tax collection burdens. *Quill, supra*, at 304 n. 2. The Court obviously believed it of greatest importance to protect both in-state and out-of-state businesses equally from unfair burdens imposed by foreign jurisdictions.

[14] States where Amazon is now (or scheduled) to collect sales tax: AZ, CA, CT, FL (2016), GA, IN, KS, KY, MA, ND, NJ, NV, NY, PA, SC (2016), TN, TX, VA, WA, WI, WV

[15] U.S. CONST. art. I, §10, cl. 3.

[16] U.S. CONST. art. II, §2.

[17] U.S. CONST. art. I, §10, cl. 1 prohibits states from entering into a "Treaty, Alliance, or Confederation" – even with congressional approval.

"compact," but rather would constitute an impermissible "treaty, alliance, or confederation." The Constitution plainly forbids such arrangements among states.[18] In contrast to interstate compacts, which may be given validity if Congress approves, the Constitution pointedly withholds from Congress the authority to approve such forbidden multistate alliances.

MFA by its terms purports to delegate to the SSTP Governing Board the ongoing authority to exercise federal power throughout the United States. In particular, MFA effectively gives the Governing Board *carte blanche* to prescribe and to change tax rules for member states on an ongoing basis. Moreover, under MFA, a state's membership in the SSTP gives that state the power to impose tax collection burdens and audit sellers in every other state. This power would extend even to states that do not join the SSTP. Even if this authority were exercised only in member states, its impact would clearly be national in scope, and its exercise would be continuous.

This indefinite and ongoing power to interpret and redefine the SSUTA, which MFA delegates to the SSTP's Governing Board, is the reason the arrangement also violates the Appointments Clause.[19] Under the Appointments Clause, only those officers of the United States properly appointed within the executive or judicial branches can "exercise[e] significant authority pursuant to the laws of the United States."[20] But under MFA, the SSTP Governing Board, consisting of officials appointed not by the President but by member states, would wield extensive influence throughout the nation. Specifically, MFA would delegate to these individuals (who by definition are not duly appointed "officers of the United States") the uniquely federal power to decide when and under what circumstances SSTP member states would be authorized to engage in activity otherwise in violation of the Commerce Clause. The Governing Board could decide which states may tax remote sales, promulgate rules governing inter-state sales and use taxation, and interpret what is and is not subject tax. Such an

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[18] As noted in Paul Clement, Patricia Maher, and Zachary Tripp, *Constitutional Difficulties of Proposed Streamlined Sales Tax Legislation* (King & Spaulding, Oct. 2009), p. 1 (*accessible at* http://netchoice.org/clement2), "The Framers understood the Compact Clause to play a limited role relating to the resolution of regional disputes, not to be a mechanism by which a minority of states could make and execute national policy."

[19] U.S. CONST. art. II, §2, cl. 2.

[20] *Buckley v. Valeo*, 424 U.S. 1, 126 (1976).

arrangement would amount to Congress handing over to the Governing Board "the keys to the Commerce Clause itself."[21]

Principles to Guide Congressional Action

A first principle in drafting legislation, just as in medicine, is "*do no harm.*" Today's system of sales taxation is fundamentally fair to interstate commerce and to all stakeholders, because brick-and-mortar, brick-and-click, and e-commerce businesses alike are protected from unfair out-of-state tax compliance burdens. When a customer walks into a hardware store in Tucson, the clerk does not ask what state and county the customer lives in, so the clerk may compute sales tax accordingly. Instead, the Tucson clerk always charges the local tax rate, no matter where the customer lives. In this way, the brick-and-mortar business is protected from having to comply with the tax laws and filing requirements of 46 other states. This is the same protection that an e-commerce business enjoys.

It is important to note that this is the exception, not the rule. Even without any change in federal law, most sales taxes on e-commerce are already being collected. As of 2013, 17 of the top 20 e-retailers were *already* collecting sales taxes in at least 38 of the 46 sales tax states. It has been publicly reported that within two years, Amazon will have physical presence in states that are home to two-thirds of all Americans. With no change in federal law, therefore, the lion's share of sales tax from Internet retail is already being collected.

It is also important to note that the competitive threat to brick-and-mortar retail from e-commerce comes largely from factors other than sales taxes. There is abundant evidence for why people shop online and through catalogs: they are looking for convenience, selection, and lower prices. Indeed, there is no persuasive data showing that avoidance of sales tax is a principal motivation of online and catalog shoppers. To the contrary, all the evidence suggests that shoppers seek a good value by comparing prices *before* tax is added at checkout. Moreover, shipping and handling charges for remote sales frequently exceed any sales tax avoided. Finally, Amazon posted impressive year-over-year sales gains in 2013 in states where it *added* sales tax collection for its customers.

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[21] Clement, Maher, and Tripp, *supra,* at 15.

Still, there is a deeply held belief that current law is unfair to brick-and-mortar stores. If Congress is committed to overrule the Supreme Court's decision in *Quill* in pursuit of fairness and tax revenue, it must do so with great caution so as to maintain the current protections against out-of-state regulation and taxation that are enjoyed broadly by all retailers. My testimony on how this Committee might find a better way than MFA should be understood in this vein.

Once resolved to "first, do no harm," this Committee can do no better than to follow the *Basic Principles on Remote Sales Taxes* that Chairman Goodlatte has announced. NetChoice supports these Principles entirely, and appreciates the specific explanations and contextual meanings provided for such essential terms as fairness, simplicity, and states' rights.

As a first step, it is useful to compare the Principles to the MFA as it passed the Senate in March 2013. As will be seen in the table below, the MFA fails across the board to achieve the objectives of the Principles.

Judiciary Committee Principles	Marketplace Fairness Act of 2013
1. Tax Relief – Using the Internet should not create new or discriminatory taxes not faced in the offline world. No fresh precedent for other areas of interstate taxation by States.	MFA Fails. Only businesses selling online or via catalog would face new requirements to collect taxes based on where the purchaser lives, as well as compliance and audit demands from 46 states – each with its own rates and rules.
2. Tech Neutrality – The tax compliance burden on online sellers should not be less, but neither should it be greater than for similarly situated offline businesses.	MFA Fails. MFA forces internet and catalog sellers to file in and comply with the differing rules of 46 states – plus up to 550 Indian tribes in the Senate-passed version. Brick-and-mortar businesses would comply only with the rules of the states where they are located.
3. No Regulation Without Representation – Those who would bear state taxation, regulation and compliance burdens should have direct recourse to protest unfair, unwise or discriminatory rates and enforcement.	MFA Fails. There is no recourse for Internet sellers when out-of-state tax authorities make unreasonable demands for taxes, paperwork, and audits. Internet sellers must travel to foreign states and face foreign courts.
4. Simplicity – So simple and compliance so inexpensive and reliable as to render a small business exemption unnecessary.	MFA Fails. States were not required to have common rules and definitions. Lacking true simplification, and offering no help with software integration, MFA purports to exempt small businesses but fails even to do that.
5. Tax Competition – Governments should be encouraged to compete to keep tax rates low and American businesses should not be disadvantaged vis-a-vis foreign competitors.	MFA Fails. States were not required to have common rules and definitions. Lacking true simplification, and offering no help with software integration, MFA purports to exempt small businesses but fails even to do that.
6. States' Rights – States should be sovereign within their physical boundaries. Congress should not mandate that States impose any sales tax compliance burdens.	MFA Fails. MFA gives new tax and audit powers to every state, allowing them to reach across their borders. This threatens the sovereignty of every other state. Other states would not be able to opt out of MFA; rather Congress would mandate their submission to other states' business activity taxes and regulations.
7. Privacy Rights – Sensitive customer data must be protected.	MFA Fails. MFA has no privacy protections whatsoever. Worse, it incentivizes out-of-state tax collectors to demand customer information from retailers.

The most significant reason that MFA fails all seven of the Principles is that it would force catalog and Internet sellers to incur significant new tax compliance costs that are not borne by brick-and-mortar retailers. Instead of leveling the playing field, MFA would heavily discriminate against e-commerce. Under MFA, brick-and-mortar stores would not have to

comply with out-of-state tax rules where they have no physical presence, but e-commerce stores would. Moreover, because these costs are disproportionately expensive for small businesses, the small e-commerce firms would be hardest hit.

The SSTP's own Cost of Collection[22] study found that the smallest businesses spend 17 cents for every tax dollar they collect for states. That is vastly more than their large-scale competitors. Even if the "free" tax software were to work as advertised (and as explained later, it will not), that would help eliminate only two cents of the extra costs. So a small business with annual revenues of $1 million would still incur a new cost burden equal to 15 cents on every dollar it collects, for tasks such as:

- 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 entity and use exemptions and sales tax holidays
- Responding to audit demands from 46 states – plus up to 550 Indian Tribes, per S.743
- Accountants and IT consultants to help with all of the above

These collection burdens will impose impossibly high costs on small catalog and online businesses. Ask any small business – a brick-and-mortar store on Main Street, or an online store – and you'll hear it's hard enough to collect sales tax for one state. It would be a nightmare for a small business to have to comply with the rules of all 46 states, each with sales tax rates, regulations, and unique filing burdens of its own.

The most significant of these costs is the expense of integrating tax rate lookup software into the business's in-house information systems. The cost is high not only because the software integration requires specialized skills, but also because it must be done at multiple integration points. Last year, the True Simplification of Taxation (TruST) coalition commissioned a study to precisely measure both the upfront and ongoing software integration costs. The study examined both catalog and online retailers in the mid-market bracket ($5 - $50 million in annual sales).[23] The study found that such mid-market online and catalog retailers would have

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

[23] Larry Kavanagh and Al Bessin, *The Real-World Challenges in Collecting Multi-State Sales Tax*, September 2013.

to spend $80,000 to $290,000 in setup and integration costs in order to use the so-called "free" software promised by advocates of the MFA.

Beyond the average $185,000 initial cost, every year these retailers would also have to spend between $57,500 and $260,000 on maintenance, updates, audits, and service fees charged by software providers. These findings explode the myth of plug-and-play integration:

> Most mid-market retailers have modified third party order management software to fit their business processes or have developed their own software. They use these order management systems for call center order entry, customer service, returns and refund processing, inventory management and more. In many cases, these systems also integrate to separate accounting systems. In order to integrate with a CSP [Certified Software Provider], the retailer must make architectural modifications to map to the coding system of the CSP, establish real-time communication, and create protocols to handle transactions when the real-time service fails to return a valid reply.

For a visual explanation of the software integration challenges, see the diagram below:

MFA's carve-out for small business does not begin to address this problem. The exemption of businesses with up to $1 million in annual remote sales still leaves many very small firms unprotected from the outsized new costs and burdens that MFA would impose. A company with $1 million in sales over a 12-month period is typically just a one or two person

business. As NetChoice has explained in previous testimony, an exemption of at least $15 million in annual sales would be needed to achieve the intended purpose of protecting small businesses whose scale would not permit them to absorb MFA's exorbitant costs.[24]

A recent study claiming that a $1 million small business exemption would protect all but about 1,000 online businesses from MFA is grossly inaccurate. The study commissioned by the U.S. Small Business Administration (SBA),[25] inexplicably chose to rely upon the same University of Tennessee professors who admitted their earlier estimate of uncollected sales tax, overstated *by 70%*.[26] In the SBA November 2013 report, the professors advance the demonstrably false assertion that MFA would affect only 974 online sellers.

There are several reasons this estimate should not be relied upon when considering legislation. First, the authors heavily rely on calculations from a 2008 study that found that there were in fact 28,628 online sellers with sales over $1 million[27] -- significantly more than the 974 found by the SBA study. Second, the SBA study's authors based their study on the patently false assumption that *anyone* who *ever* sold any item on eBay is an online business.[28] This became the basis for their claim that "99% of online businesses are less than $1 million." It is preposterous to include an individual who sells a used bicycle on eBay, Craigslist, or a newspaper classified ad web page within the definition of "online businesses." Third, the study relied on the *Internet Retailer Top 1000* to identify the universe of online sellers with over $1 million in sales, even though that publication explains that its listing of websites in the top 1,000 is based *solely on web traffic*.[29] This definition does not even purport to be a fair proxy for online sellers with more than $1 million in revenue. A few examples will quickly illustrate:

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[24] NetChoice Testimony for House Judiciary hearing, H.R. 3179, the "Marketplace Equity Act of 2011" (July 7, 2012)

[25] Bruce & Fox, *An Analysis of Internet Sales Taxation and the Small Seller Exemption*, Nov. 2013

[26] *See*, Donald Bruce, William F. Fox, & LeAnn Luna, *State and Local Government Sales Tax Revenue Losses from Electronic Commerce, University of Tennessee Working Paper* (Apr. 13, 2009), Donald Bruce & William F. Fox, *State and Local Sales Tax Revenue Losses from E-Commerce: Updated Estimates*, University of Tennessee (Sept. 2001)

[27] Bailey, Gao, Jank, Lin, Licas, Viswanathan, *The Log Tail is Longer than You Think*, May 2008

[28] Fox at 28.

[29] Internet Retailer, *Top 500*, 2012 p. 105 ("The starting point for the data gathering was the rankings of *retailers' web traffic*.")

- *SchreinersGardens.com in Salem, Oregon* – Sixty-five years ago, Schreiners Gardens opened its first flower store. Later it added a catalog and eventually a web store. Schreiners now exceeds $1 million in remote sales. As a specialty store, it is highly unlikely it will ever make the top 1000 in web traffic.
- *MissouriQuiltCo.com in Hamilton, Missouri* – This business opened a store in 2008 but soon "it soon became apparent that in a town of 1100 people it would be difficult to produce enough revenue to employ our parents and also make a decent profit. This was the impetus behind growing [their] business online."[30] After opening its online store, MissouriQuilt grew into the largest employer in Caldwell County. It has boosted local tourism as quilters from around the world come to meet the owners and take quilting lessons. MissouriQuilt does over $1 million in sales. Again, as a specialty store, it did not make the top 1000 in web traffic.

For these reasons, it is difficult to give any credence whatever to the SBA report. In fact, sampling in Oregon alone, NetChoice found 60 small e-commerce businesses with over $1 million that were overlooked in the SBA report.

The conclusion one must draw from this is that MFA is fundamentally flawed. Even the purported carve-out for small business would prove woefully inadequate – it would need to be at least $15 million in annual sales, as we testified in 2012.

Once it is understood that MFA's approach is fundamentally costly, discriminatory, and potentially unconstitutional, the door is opened to consider other approaches.

There's a better way than MFA: Home Rule and Revenue Return

NetChoice accepted Chairman Goodlatte's challenge to develop alternatives to MFA. Beginning with the Principles, and being especially mindful of the due process limitations on the states' power to force tax compliance burdens on out-of-state businesses, we have conceptualized the approach of Home Rule and Revenue Return, by which Congress could authorize states to collect taxes when their residents purchase from out-of-state sellers.

The central concept is a voluntary multi-state Compact that would establish clear rules for interstate purchases on which sales tax currently is not being collected. States participating in the Compact would realize sales tax on purchases their residents make from remote businesses located in other Compact states.

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[30] http://MissouriQuiltCo.com/Content/AboutUs

This concept treats catalog, online, and brick-and-mortar sellers the same. Every business would use the tax rates and rules that apply where it is located – not where the customer resides. This approach involves no new complications, because most retail business already takes place this way. Using the tax rates and rules where the business is located is already the rule for all brick-and-mortar sales. When a customer from Maryland buys a tool at a hardware store in Virginia, the store clerk does not inquire what state and county the customer is from. The clerk simply rings up the sale and applies the local Virginia sales tax. This is also the existing rule for all intrastate catalog and online sales in 17 states representing over half the nation's population.[31] Because of its inherent simplicity, both SSTP and MFA allow these states to retain this rule for intrastate sales by catalogs and websites, since trying to use the customer's residence as the source of tax rates and rules in each case would be too complex and expensive.

Unlike an origin-based system, which leaves tax money in the business's state even though the purchaser is from another state, the Home Rule and Revenue Return concept would distribute taxes received from out-of-state purchasers to their home states. This results in states receiving sales tax revenue from their residents' out-of-state purchases, without imposing massive new compliance burdens.

The table below summarizes how the Home Rule and Revenue Return concept meets each of the Committee's Principles. Details of the concept are more fully explained in the following section.

[31] **AR** AZ CA **IA** IL MO **NC OH** OK PA **RI TN** TX **UT** VA **VT WA** (SSTP member states in bold)

Judiciary Committee Principles	Home Rule & Revenue Return
1. Tax Relief – Using the Internet should not create new or discriminatory taxes not faced in the offline world. No fresh precedent for other areas of interstate taxation by States.	▪ States can join a multi-state compact to collect and distribute sales tax on remote purchases where tax is not now being paid. ▪ Treats remote sellers and brick-and-mortar businesses the same – using tax rates and rules for where the business is located – *not where the customer resides.* ▪ Establishes national standard, preempting state laws that purport to authorize alternative means to go beyond *physical presence* for tax imposition. ▪ Creates no new or discriminatory tax burdens.
2. Tech Neutrality – The tax compliance burden on online sellers should not be less, but neither should it be greater than for similarly situated offline businesses.	▪ Just like brick-and-mortar businesses, all online and catalog sellers file and pay taxes in states where they're located. ▪ All businesses are subject to sales tax audits only from those states where the business has a physical presence.
3. No Regulation Without Representation – Those who would bear state taxation, regulation and compliance burdens should have direct recourse to protest unfair, unwise or discriminatory rates and enforcement.	▪ Businesses are accountable only to the states where they are located for tax payments and audits, and for court appearances. ▪ States seeking to bring businesses in other states into court must adjudicate in the business's home state or in federal district Court. ▪ States may quit the compact if new tax burdens exceed the benefits.
4. Simplicity – So simple and compliance so inexpensive and reliable as to render a small business exemption unnecessary.	▪ Whether online or offline, small businesses pay sales tax the same way they do now: based on rates and rules of their home state. But now they would do this on sales to customers in *all* compact states. ▪ Simple and equal treatment: online and brick-and-mortar stores follow the tax regimes where they are located.
5. Tax Competition – Governments should be encouraged to compete to keep tax rates low and American businesses should not be disadvantaged vis-a-vis foreign competitors.	▪ A business in a compact state must collect tax on sales to customers in other compact states. ▪ A compact state has incentive to keep its tax rates low, since high taxes may discourage business from locating there.
6. States' Rights – States should be sovereign within their physical boundaries. Congress should not mandate that States impose any sales tax compliance burdens.	▪ States maintain control over tax burdens imposed on any business located in the state. ▪ Compact participation is decided by state legislatures, which can also decide to quit the compact if new tax burdens exceed the benefits.
7. Privacy Rights – Sensitive customer data must be protected.	▪ Compact states must implement privacy and security protections for all personal data on customer purchases.

Details of the Home Rule & Revenue Return Concept

1. ***Establish a multistate compact.*** New federal legislation would authorize a multistate compact (the "Compact") to enable collection of taxes on remote sales between sellers and purchasers in Compact states. A member state of the Compact would require its in-state businesses to collect and remit sales tax on sales to purchasers located in other Compact states.

2. ***Uniform national standard.*** The federal legislation would point states to the Compact as the sole method for imposing tax on sales made by a business to purchasers located in states where the business has no physical presence. This legislation would codify the physical presence standard similar to HR 2992, which requires: an employee assigned to the state; services of an exclusive agent necessary to maintain the market in a state; or lease/ownership of tangible or real property in a state[32]. As in HR 2992, this physical presence standard would exclude *de minimis* presence of less than 15 days in a state during a taxable year, or presence to conduct limited or transient business activity.

A statutory physical presence standard would prevent states from attempting to impose sales tax liability based on advertising arrangements, commonly controlled groups, or other means to reach businesses that lack a physical presence in the taxing state. The Compact would be the only means for a state to impose sales tax liability on businesses without physical presence in that state.

3. ***State sovereignty and optional participation.*** Each state could choose whether to join the Compact. If a state joins, then businesses in that state would continue to apply the same tax rates and rules as before. In addition, a business in that state would also collect tax on sales to purchasers in other Compact states where the business does not have a physical presence. If a state chose not to join the Compact, businesses in that state would continue collecting sales tax on sales to purchasers in other states where the business also had a physical presence.

Each state, not the federal government, should determine the extent to which it wishes to rely on sales tax. Being faithful to this principle means respecting the sovereign rights of

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[32] HR 2992, "Business Activity Tax Simplification Act of 2013", August 2, 2013, with sponsors Mr. Sensenbrenner, Mr. Goodlatte, Mr. Scott of Virginia, Mr. Bachus, Mr. Chabot, Mr. Duncan, Mr. Jordan, Mr. Jones of North Carolina, and Mr. Hastings. http://thomas.loc.gov/cgi-bin/query/z?c113:H.R.2992:

those few states that have no sales tax. In allowing each state to decide whether it wishes to join the Compact, the concept respects this principle.

Neither fairness nor revenue generation justifies violating this principle. The argument that Internet businesses will move to jurisdictions with no sales tax is spurious. Businesses are free to move today, but we have not witnessed this phenomenon. Businesses select their jurisdiction for a host of reasons: quality of life; business incentives; income and property taxes; quality of work force; etc. For example, online seller NewEgg.com chose to base its operations in New Jersey, just 80 miles from tax-free Delaware. Amazon chose Seattle, when it could have chosen Portland, just a couple of hours to the south – in a state that has no sales tax.

4. *Home Jurisdiction.* Since the fundamental principle of the concept is that every business – whether brick-and-mortar, online, or catalog – will collect and file taxes in the state where it is located, the legislation must clearly define where a business is "located" for this purpose. Once a state joins the Compact, each business with a physical presence in that state would designate one principal place of business in the United States. This will be its "Home Jurisdiction." The designation could not be manipulated: the seller's Home Jurisdiction would be the Compact state in which its greatest number of employees works, per payroll tax records. The federal legislation would also describe instances where the "number of employees" would not be an appropriate measure, and prescribe methods to use, as alternative means of designating Home Jurisdiction, either the state where most physical assets are located or the state designated as the principal place of business for federal income tax purposes.

Federal legislation would also describe instances where the "number of employees" may not be an appropriate measure, and prescribe methods to use an alternative means of designating Base Jurisdiction, such as where most physical assets are located or the principal place of business for federal income tax purposes.

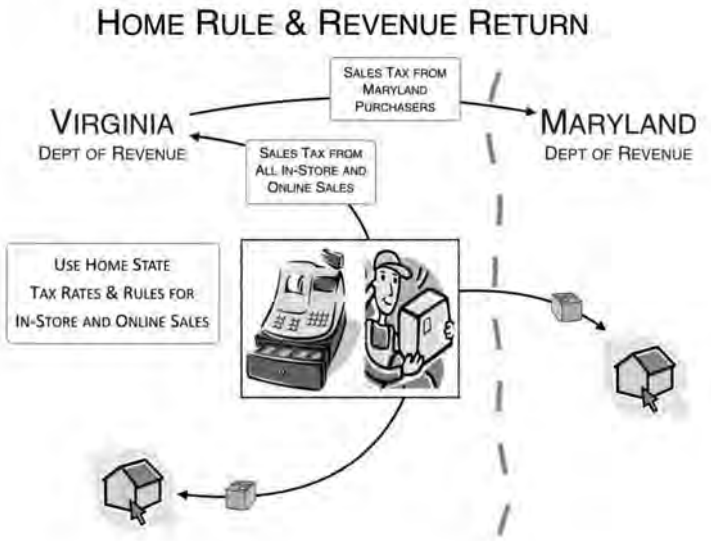
Home Jurisdiction is a proven method of taxation in multistate compacts. The International Fuel Tax Agreement[33] allows truckers to file in their "Base Jurisdiction" instead of filing taxes in every single state they drive through. Similarly, the European Union uses a similar

[33] International Fuel Tax Association, Inc., http://www.iftach.org/

concept of "home jurisdiction" to tax out-of-country sales involving customers in other EU member states.[34]

Notwithstanding the Home Jurisdiction designated by a Compact state seller, a business must fulfill sales tax obligations for any state where it has a physical presence, according to the rates, rules, and tax holidays for those states, whenever selling to customers in those states.

Nothing in this concept would change the collection of sales tax at the cash register. In-store purchases will still collect at the store's local rates and rules. Home jurisdiction only apples to sellers in compact states selling into another compact states where the seller has no physical presence.



[34] Even before e-commerce, the EU recognized the burdens placed on businesses that make sales into EU states where they have no physical presence. The EU and UK provide a home state rule for any remote seller below a per-nation sales threshold. At the same time, the EU and UK allow businesses to opt into collecting and remitting for a foreign state into which they sell. Under this system the majority of "distance sale" sellers collect and file VAT per their home state rules. http://ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/vat_on_services/

5. ***One simple rule for tax collection.*** Once a business in a Compact state designates its Home Jurisdiction, it will be required to collect sales tax on any sale to residents of other Compact states where it has no physical presence, subject to these simple rules:

- Regardless of where the purchaser resides, the business will use the tax rates, definitions of taxable goods and services, and tax holidays that apply to the Home Jurisdiction.
- The business is required to file tax returns and remittances only in its Home Jurisdiction.
- The business is subject to audits only by the state tax authorities of its Home Jurisdiction.

No state, whether or not it has joined the Compact, could demand payments or audits from a business that has no physical presence in that state.

6. ***One source of audit for remote sales***. Every business will be subject to audit only by the state and local tax authorities where it has a physical presence, just as occurs now. A business that sells to customers in states where it has no physical presence would be subject to audit on those sales only by its Home Jurisdiction.

Under the Compact, no other Compact state may demand payments or audits, except by submitting those demands to the business's Home Jurisdiction. Businesses would therefore not be required to respond to audit demands from a state where the business has no physical presence or representation.

7. ***Legal challenges to state tax authorities***. Business taxpayers would have the right to enforce the Principles of the federal legislation in reply to legal demands from Compact states. For this purpose, business taxpayers would be entitled to use the federal district courts – instead of litigating in the courts of the foreign state in question. This would require amendment of the Tax Injunction Act,[35] which presently bars federal court jurisdiction.

8. ***No multiple taxation.*** Compact states would not impose additional tax liability on their residents who purchase from out-of-state sellers, beyond what is collected from the purchaser under the terms of the Compact. A purchaser would therefore not be liable for additional "use tax" if the out-of-state seller's Home Jurisdiction tax rate were less than the purchasers' state and local sales tax rate.

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[35] Compact states would also be required to waive their 10th and 11th amendment immunity for suits brought under the Tax Injunction Act.

9. ***Privacy rights protected.*** The federal legislation would require all Compact states to adopt privacy and data security safeguards for any purchaser information they collect in the course of administering sales tax filing or use tax reporting. For this purpose, the Payment Card Industry Data Security Standard could be required as a data security safeguard. In addition, the legislation would require independent audits of state data security practices.

For states that gather specific purchaser data for purposes of use tax compliance, the federal legislation would require that an independent clearinghouse first strip-off any data identifying the vendor and the goods or services that were purchased.

10. ***Revenue return.*** The federal legislation would require Compact states to periodically forward sales tax revenue paid by out-of-state purchasers to the states where the purchasers reside. This is similar to the clearinghouse approach that allocates tax revenue under the International Fuel Tax Agreement. Revenue return would require that businesses in Compact states include in their tax filing the amount of aggregate sales to purchasers from each state, but would not require reporting of the identities of purchasers or the nature of their purchases.

Conclusion

Quill's physical presence standard remains a principled and practical way to limit states' imposition of tax and audit burdens on out-of-state businesses. Congress should follow the principle of "first, do no harm" in considering whether to discard *Quill.* Should the Congress choose to exercise its power under the dormant Commerce Clause, it is essential that you observe the constraints on state taxing power imposed by the Due Process Clause.

The Home Rule and Revenue Return plan is an alternative to MFA that achieves this objective. It is sufficiently simple that small businesses may not need an exemption. All businesses would use the same tax rates and rules they already use today for in-state sales. There would be little new compliance burden. There would be no need to integrate new software to look up rates and rules for the other 45 taxing states. Retailers could continue filing tax returns and facing audits only in their home states. Such a system would fully comply with the *Basic Principles on Remote Sales Taxes* established by this Committee.

Mr. GOODLATTE. Thank you, Mr. Cox. Thank you all for excellent testimony. We will now begin our round of questioning, and I will recognize myself for that purpose.

Mr. Kranz, you have been involved in the Streamline Sales Project process for many years. There was a time when the congressional sales tax bills required States to join the SSTP, to join the system. In addition, the SSTP regime in the early years was less flexible than now. Now States have more flexibility in the SSTP, and States can gain the collection authority without even joining them. Why has simplification been abandoned to such a degree?

Mr. KRANZ. Mr. Chairman, I do not think simplification has been abandoned, and the rules for joining SST remain the same. What I think we are seeing is that the States over 15 years of trying to simplify and gain congressional authority to require remote sellers are wearing tired of living by those rules. And so they are relaxing enforcement of the compliance standard, and by that, they are holding certain members to be out of compliance with certain provisions of the agreement and giving them time to get back into compliance.

It is a natural ebb and flow at the State level of the law in response to the agreement's requirements. But I do not think that they are abandoning simplification by any stretch.

Mr. GOODLATTE. Thank you. Mr. Cox, some of today's proposals seem to suffer from privacy concerns, others from the burdens of compliance and cross-border audits. Is it fair to say your proposal dodges both those major pitfalls, and if you think that is the case, please explain why.

Mr. COX. Yes, and those are two very serious problems. I think we all know with the Target data breach as a leading example what can happen if information about customers is now, in a more granular way, collected by purchase. If appointed officials, elected officials in every one of the 9,600 jurisdictions around America have a right to demand what you bought at a particular store to find out if it was taxable in their State, that creates opportunities for mischief that I think ought to frighten us. That is the kind of big government threat that we do not want, and so, avoiding that is very important. And that is not at all an element of home rule and revenue return.

The other problem, the basic problem, that has challenged this simplification effort for so many years since I began talking about it with Governor Leavitt back in the 1990's is the idea that you have the many against the one. You have got a business that is in one place, and yet now it is exposed to regulation by at least 45 other States and possibly thousands of different individual jurisdictions.

And so, you see that problem at its worst when it comes to audit. If you never get audited, maybe there is a way for computers to help us out here. But if you have to face compliance demands from all these places, if they have personal jurisdiction over you in an International Shoe sense and they can compel you to show up there (which definitionally they would—if they can tax you, they can regulate you, and they can make you personally appear, as was point-

ed out earlier in testimony)—you know, that is a horrific problem. And so avoiding that problem also is very important.

Mr. GOODLATTE. Thank you. Mr. Crosby, the Streamline Sales Project originally sought one tax rate per State. Too many States were unwilling to do it, and it was abandoned. With a narrower focus on remote sales only, do you think a single rate might be achievable?

Mr. CROSBY. Mr. Chairman, in the early days of the discussion, one rate per State was certainly talked about with the National Tax Association Advisory Commission on Electronic Commerce. When the Streamline Project came together, the focus was on administrative simplification, looking at those aspects of the sales tax system that truly bring burdens to sellers and simplifying those.

The rate issue is radically diminished from 20 years ago because software actually can handle that very well. If there is something that software can do well, it is look up rate tables and apply those rates. So that issue I think is not as important.

Also in the Streamline Project, what came to the fore is that we frequently think only of business to consumer sales. Business to business sales are, in fact, more than 90 percent of e-commerce. Many States provide preferential rates or exemptions for business to business purchases, for example, on aviation fuel. If there were a mandate to require one rate per State, it could jeopardize those existing preferences the State provides to encourage business activity.

Mr. GOODLATTE. Mr. Moylan, Salem County, New Jersey is exempt from collecting the 7 percent Statewide sales tax. Instead, it collects just 3 and a half percent local tax. The reason is that Delaware is next door, and Delaware has a sales tax of zero. Is the lesson that tax competition is a real phenomenon, and to what extent do you think that is true?

Mr. MOYLAN. I think, yes, that is the lesson that tax competition is a real phenomenon, and I think that it is a beneficial element for taxpayers. It is interesting that you bring that up, however. I think that, and I wrote this in my written testimony, that the more likely manifestation of that sort of tax competition is in those sorts of marginal decisions in a given area. And I use the example of the D.C. metro area that you might see businesses deciding to locate on the Virginia side of the border rather than the Maryland side of the border to take advantage of Virginia's somewhat more beneficial business and tax climate.

I do not think that you are likely to see some sort of wholesale stampede to New Hampshire or Montana. And, in fact, any sort of Federal rule on origin sourcing should establish clear protections to make sure that businesses cannot game the system. We, of course, would not want a situation where people can set up a mailbox in New Hampshire and avoid collection forever more.

And so I think that there are ways appropriately to protect against that while encouraging the kind of beneficial competition that you point out happening in New Jersey.

Mr. GOODLATTE. Thank you. My time has actually expired, and the Chair recognizes the gentleman from Michigan, Mr. Conyers, for his questions.

Mr. CONYERS. Thank you. I appreciate the witnesses' testimony. It is quite varied. I would like to begin with Mr. Kranz. What, in your view, is the risk of Congress not acting on the remote sales tax issue? And in the absence of congressional action, what will States do moving forward?

Mr. KRANZ. Thank you, Ranking Member. The risk of Congress not acting is that the States will continue their onslaught attack against remote commerce. And as I mentioned earlier, there are already 17 States that have tried a variety of approaches to attack remote commerce imposing complicated administrative burdens, audit risk, liability, and potential litigation on those remote sellers.

So if Congress does not act, my prediction is that the States will continue that attack on remote commerce. And we are seeing it today. There were four cases decided last year, two in New York, one in Illinois, and one in Colorado, all related to these State attacks against remote commerce.

Mr. CONYERS. Thank you. Mr. Crosby, regarding the idea that one rate per State would enable more simplification, has it been contemplated before, and what are the challenges with that? Is it fair to jurisdictions with lower rates?

Mr. CROSBY. Mr. Conyers, I think that the focus on one rate per State reflects a misunderstanding of the complexity that is associated with sales taxes. Complexity is driven by things other than the rate calculation. As I mentioned before, software is capable of doing that sort of thing.

If the Congress were to impose one rate per State, it would likely lead to a leveling up of taxes in States that have lower rates. So where you have local jurisdictions with lower rates, a mandate of one rate per State would likely result in a tax increase in those States. It would also, of course, be a reduction in State sovereignty by reducing the flexibility they have to set their own tax rates on their basis.

Mr. CONYERS. Thank you. Mr. Kranz, you stated in your testimony that some proposals that you will hear today will trample State tax policy decisions and have far-reaching economic impacts. You give examples of origin sourcing. Please expand on how origin sourcing would create economic hindrances by turning what is now a consumption tax into a production tax. And also how would such a proceeding be constitutionally impaired?

Mr. KRANZ. The proposals we have heard today for origin-based taxing would eliminate what we now know as our sales tax system in this country. When someone in Virginia buys at a Virginia store, they pay Virginia tax and it funds Virginia government services. When someone with a Virginia address buys from a vendor located in California, and that California company has an obligation to collect tax, they collect Virginia's tax, and that money gets remitted to Virginia to fund Virginia government services.

An origin regime for remote sellers would turn that on its head and have far-reaching economic implications. Under an origin regime, the remote seller would collect California's tax rate and would collect tax based on California's rules. The two proposals you have heard today for origin sourcing, one of them would allow California to keep the money, and the other one would say, no, the ven-

dor in California has to collect California's tax rate, collect under California's rules, but we will redistribute that money to Virginia.

Ultimately, both of the origin proposals, though, impose a different State's tax rules on a Virginia consumer. So consumers in your State would be subject to the tax laws of the location where the seller is located. Now, as a tax lawyer, I can easily come up with a vehicle to get out of that, and I would inform any company to create a new entity in Delaware, or in New Hampshire, or in Montana, one of the non-sales tax States. That entity becomes the seller of record. You can have all your operations somewhere else, but the seller of record is located in a non-sales tax State.

Mr. CONYERS. Let me get this in before our time runs out. Some are concerned that the due process clause would be offended by Federal legislation to authorize remote sales tax collection. What are your thoughts? Did *Quill* not address this?

Mr. KRANZ. *Quill* did address the question. Congress has commerce clause authority to pass a Federal framework. There is nothing that Congress can do to remove the due process protections. Whether you address the issue or not, taxpayers and businesses have their due process rights. Passing legislation to deal with this issue does not touch those rights. They would still exist and be fully protected.

Mr. CONYERS. Thank you so much. I return any time that may be left.

Mr. GOODLATTE. The Chair thanks the gentleman and recognizes the gentleman from North Carolina, Mr. Coble.

Mr. COBLE. Thank you, Mr. Chairman. Good to have you all with us this morning. Mr. Sutton, under the hybrid origin regime, taxpayers would pay the sales tax rates based upon from where they ought to be shipped rather than where the taxpayer resides. In many instances, this could be viewed as a tax increase if the item is shipped from a high sales tax State to a low State tax State. What say you to that?

Mr. SUTTON. It absolutely could be perceived by the consumer, who is the ultimate bearer of the tax, whether it is based on the business or not. The businesses have to raise the tax, have to raise their price to account for that tax, whether it is a separate line item or not. So the consumer is the one that ultimately pays for it, so, yes, I believe that would be perceived as an increase by many consumers out there.

I also believe that the great State of Montana would probably have to be some movement to be renamed as Amazon-tana before long for the sheer volume of companies that would start moving there to base their retail sales, both remote and on the internet.

Mr. COBLE. I thank you, sir. Mr. Moschella, how could the Congress define the origin from where it originates? For example, would the rate be determined where the company's physical headquarters are located, A, or, B, the warehouse from where the item is shipped, or even C, where the corporation is incorporated?

Mr. MOSCHELLA. Well, it is a good question. I think Mr. Kranz may be in a better position to answer that question.

Mr. COBLE. I will be glad to hear from Mr. Kranz.

Mr. KRANZ. Well, the proposals we have heard do not give an answer to that question. They leave it open-ended. There is one possi-

bility that it would be based on the number of employees in the company. But again, I could very easily create a Delaware entity with one employee. That is the only employee, and it is a Delaware company or a Montana company. The seller of record can easily have a no sales tax collection obligation under the origin regime. It is a simple game that could be used to avoid these proposals.

Mr. MOYLAN. Congressman, may I respond to that——

Mr. COBLE. Sure.

Mr. MOYLAN [continuing]. Because I did cover it in my testimony. Several of the States that utilize origin sourcing for intrastate sales have answers to this question that I think can be effective guidance for Congress. The Chairman's home State of Virginia is an example, Texas another. What they do is, one utilizes the place at which an order was received and processed. Others have utilized the location from which the item was shipped. You could explore some version of either of those, some sort of combination.

I think that there are ways that you can appropriately structure the rules so that you do not have the sort of gaming that Mr. Kranz is referring to and that you have a legitimate rule, much the way that the 17 States that utilize origin sourcing intrastate do.

Mr. COBLE. I thank you, sir. I am going to try to get one more question. Mr. Cox, as has been said, welcome back to the Hill. This may be portrayed, Mr. Cox, as an off the wall question, but let us give it a try. Suppose France dispatched auditors to one of our States demanding access to local business records to ensure it properly collected French sales tax on items that were shipped to the country of France? Do you think most Americans would view that as protecting U.S. sovereignty, and if not, distinguish between that and when States are doing it to one another.

Mr. COX. Well, I do not think that is an off the wall question at all. I think that is a very pertinent question because the internet cannot be restricted to the 50 U.S. States and six territories. It is global. It is called the worldwide web for a reason.

And when a business that wishes to serve its customers in the neighborhood goes on the web, you know, they are up in Italy. They are up in France. They are up in Russia. It is not untoward to think that Vladimir Putin might decide, you know, hey, we have got YouTube here, we are going to put a franchise tax on it.

We do not want that to be the norm. Because the United States was the leader in the internet—we can go all the way back to the 90's—the norms that we established in this country about relatively light regulation; in some areas, no regulation; no special taxation; no discrimination—have been the norm worldwide. There is no UN rule. There is no global compact that makes this the case. But it is U.S. leadership that has made this the case.

So if we establish a new norm through congressional enactment that nexus is created, that jurisdiction is created in a due process, International Shoe sense over someone because their website is visible in your jurisdiction, or because an incidental purchase or transaction was made over the worldwide web, then we had better get ready for France to make that demand on us.

Mr. COBLE. I thank you, sir. I see my red light has illuminated. I yield back.

Mr. GOODLATTE. I thank the gentleman. The Chair recognizes the gentleman from New York, Mr. Nadler, for 5 minutes.

Mr. NADLER. Thank you, Mr. Chairman. Let me start by making a few observations. It has been said repeatedly at this hearing that the question of enabling States to collect their use taxes is about the fairness for brick and mortar stores, brick and mortar merchants vis-a-vis online sellers.

I agree with that, but I think it is also about a far broader principle. It is about not destroying the sovereignty of the States, that enabling the people of the several States to continue to decide whether, how, and how much, whether to tax themselves, how much to tax themselves, and how to tax themselves, and those who do business in their States, that is a fundamental right of a State government. It has been greatly compromised by the development of the internet and the inability to collect use taxes for products sold over it. And we ought to be looking to protect the sovereignty and ability of the States and the people of the States to decide their own policies. That is point number one.

Point number two, and in connection with that, I should say that I support the Marketplace Fairness Act, which has passed the Senate. And I have heard some of the criticisms here, and we will address them in a minute. But I would hope that the Committee would hold a hearing on the Marketplace Fairness Act, which has passed the Senate, on possible amendments and possible changes to address some of the criticisms to see if it is possible to address adequately the criticisms that have been leveled at it.

Third, it is nice that we are holding this hearing on other approaches, as long as it does not substitute for a hearing on the Marketplace Fairness Act. And I commend the Chairman for putting out a statement of principles, but I must say I disagree with one of them. One of the principles says, "Government should be encouraged to compete with another to keep tax rates low." I disagree with that. You might want to keep tax rates low, or high, or middling. That is a decision. It is a political decision. It is an ideological decision. But it is a decision for the States and for the State electorates.

The Federal Government should be neutral on State tax policy, and the Federal Government should simply protect the State sovereignty and the ability of the States to decide for themselves what their sales tax and use tax policies ought to be. We ought to protect their ability, and they should decide whether tax rates are low or high and let local electorates vote for or against State candidates on that basis or any other basis they want to.

Now, I want to make one other observation and then go to questions, and that is on a couple of the proposals here for origin sourcing—in effect, that the tax rate would be decided by the State law, the State where it sold from—people have said that would release our rates to the bottom, and I think it would, and we have an example of that. In 1978, the Supreme Court decided that regulations of credit cards would be based on the law of the State from which issued, not of the State to which issued. So if in New York can get a credit card from a bank based in South Dakota, South Dakota's law governs.

What happens? Every bank moved its credit card division to South Dakota or Delaware where essentially they have no regulations so that every other State was forced to eliminate their usury laws. We used to have laws that said you could not charge more than X percent interest. They have all been eliminated. All the regulations have been eliminated in just about every State because they are totally unenforceable.

I was in the State legislature in the 80's when we heard this threat in New York: if you do not repeal these laws, we will move our jobs to South Dakota. We repealed the laws, and they moved anyway, and, therefore, I oppose this kind of proceeding.

Let me ask a question of Mr. Kranz. How would you reply to the various criticisms that we have heard today of the Marketplace Fairness Act, that it would lead to problems of enforcement, to audits of people out-of-State? And secondly, should the SSUTA, which is a basis of the Marketplace Fairness Act, apply only to interstate sales, not to intrastate sales, and with that eliminate the reticence of some States to join up?

Mr. KRANZ. So, on the enforcement side, the way that SSUTA and earlier versions of the Marketplace Fairness Act were put together, there was an intention and an effort by the States and the businesses involved to shift the compliance burden from remote sellers to software companies. Make the software companies responsible for tax calculation and compliance. Shift that burden. It still exists in the SSUTA and in versions of the Marketplace Fairness Act.

On interstate versus intrastate, when the SSUTA originally started, the goal was to simplify the sales tax system so that it applied to Main Street sellers and remote sellers. Give them all the simple set of rules. Earlier versions of legislation in Congress required the States to simplify their sales tax for all sellers, Main Street and remote. More recent versions are limited to just remote sellers, giving them and only them the benefit of the simplification.

Whether Congress decides that the simplifications should apply to everyone or not is a question for this body. The earlier versions of the effort tried to get there, and the more recent versions do not go there. They simply apply the simplifications to remote sellers.

Mr. NADLER. I see that my time has expired. I yield back. Thank you.

Mr. GOODLATTE. The Chair thanks the gentleman and recognizes the gentleman from Texas, Mr. Smith, for 5 minutes.

Mr. SMITH OF TEXAS. Thank you, Mr. Chairman. It is nice to see two long-time friends here, former Congressman Chris Cox and Will Moschella, whom I know you pointed out used to be a staff member of the Judiciary Committee.

I have kind of distilled all my questions down to one that I would like to address to Mr. Moschella, Mr. Sutton, Mr. Moylan, and perhaps Mr. Kranz as well. And it is this, that you all have somewhat different solutions, different proposals. But I would like to know whether you consider your proposal to be an increase in taxes or not. If so, how do you justify it, and if not, why not? And, Will, could we start with you?

Mr. MOSCHELLA. Thank you, Mr. Smith. No, our proposal is not an increase in taxes. Our proposal defers to the sovereign State de-

cisions with regard to taxing authority. It merely would say that it would be a violation of Federal law just like the Webb-Kenyon Act. It would be a violation of Federal law for a remote or direct shipper to send into that State goods in violation of the State's tax laws. And then it would be enforceable by injunction.

Mr. SMITH OF TEXAS. Okay. Thank you. Mr. Sutton?

Mr. SUTTON. Thank you. No, it definitely would not be an increase in tax. My system does not does not collect any tax. All it does is report private information completely sanitized from the vendor level into a database so the State and the purchasers have it. The States enforce their own existing use laws. That is it. They are use laws that have been in place for decades. Thank you.

Mr. SMITH OF TEXAS. Okay. Thank you, Mr. Sutton. Mr. Moylan, you feel differently about your proposal.

Mr. MOYLAN. Well, I would say the answer is no, and nor should it be, that the intention of an origin sourcing system is, and this goes back to something that Mr. Nadler pointed out, that I think we often look at this in sort of a binary fashion. We think of brick and mortar and online as being two totally separate things when in reality the vast majority of businesses are what we would call brick and click, that they have physical presence in some place and they sell online as well.

And so, what origin sourcing is about is about ensuring that they collect on the same standard for all of those sales. And to the extent that there is any revenue that is associated with that, you know, my intention would be to use that to reduce tax rates in States to make sure that there are not any net burdens on consumers. And I think that when you compare that to the alternatives, like the Marketplace Fairness Act or some of the others that you are hearing today, that the result would be much better for taxpayers.

Mr. SMITH OF TEXAS. Do you consider the Marketplace Fairness Act to be an increase in taxes?

Mr. MOYLAN. I think that the Marketplace Fairness Act, as many of my fellow panelists will point out, is about collecting taxes that are theoretically owed. I think in reality what any of these would do is, you know, is to put tax collection on the front burner. And when you do that, it often seems like a tax increase to people.

Now, what I would intend to do, as I pointed out, is to ensure that are not any increases in net burdens on people. I think that there are many States that have pointed out ways in which they would do that. Scott Walker in Wisconsin is one example of somebody who said that any changes in Federal law relating to internet sales taxes would be utilized to reduce tax rates, and I think that that is the right approach.

Mr. SMITH OF TEXAS. Okay. Thank you, Mr. Moylan. Mr. Kranz?

Mr. KRANZ. What we are talking about here is the tax gap for use tax collection, and one of the proposals would try to capture data and force consumers to pay their use tax. I used to give speeches about tax, and I would ask for a show of hands how many of you file your use tax reports annually. I stopped doing that because it was only me and one other person in the audience. It is a tax gap that is not being collected today.

On the question of is there more money, sure. If you create an enforcement vehicle, it will collect more money. What is going to happen with that money? Ten States have already introduced and are considering legislation—some have passed it—that would say if we get this money, we will reduce our income tax rates. We will reduce our sales tax rates. We want the money not because we want more money. We want it to have a balanced system.

Mr. SMITH OF TEXAS. Okay. Thank you, Mr. Kranz. Let me go back to Mr. Moschella and Mr. Sutton and ask you about the Marketplace Fairness Act. Do you consider that to be an actual increase in tax or, as Mr. Moylan suggested, just the perception of an increase?

Mr. MOSCHELLA. We do not, and our client, Simon Properties, fully supports the Marketplace Fairness Act.

Mr. SMITH OF TEXAS. Okay. Mr. Sutton?

Mr. SUTTON. I give extreme credit to everybody that has worked on the Marketplace Fairness Act. It has been an extremely well-drafted form of legislation to try to address this problem. There are definitely quirks that happen in sales tax everywhere, and there are quirks under the Marketplace Fairness Act that would increase tax, yes.

Mr. SMITH OF TEXAS. Okay. Thank you. Thank you, Mr. Chairman.

Mr. GOODLATTE. Thank you, and the Chair recognizes the gentleman from Virginia, Mr. Scott, for 5 minutes.

Mr. SCOTT. Thank you, Mr. Chairman. I was in the State legislature, too, in the mid-80's, and a local credit card company told us of the advantages of going to South Dakota. We had to change our laws, too. They did not move.

I have a question on this. In your choice of laws, would you get to choose based on where you are incorporated, where your warehouse is, or where your corporate headquarters is, or where you ship it from? Where would you choose, or do you just get to pick the lowest tax State? Mr. Cox?

Mr. COX. Thank you. I think you have heard from several panelists that it is very important for the Federal legislation to be clear on this. I think that you have every opportunity in writing a Federal law that blesses a voluntary compact to do that. If you left it open to gaming, I think you would get rather obvious consequences.

I think you could do the same thing with respect to nexus and ought to for reasons that are laid out in bloody technicolor in Mr. Kranz's testimony. If we do not have a very, very firm preemption in whatever law we write here, and we let States continue with their aggressive push on nexus, then we will also get what we deserve.

So we recommend in the home rule and revenue return proposal that we use the BATSA definition for nexus because it will answer all of those problems.

Mr. SCOTT. Okay. Well, one of the complications of this is the ability to calculate and pay the tax. I have been told that there is software that can calculate for you very easily what the tax is and a service that if you pay them one check, that they will distribute it to everywhere it goes, and that the service is free. Is that accurate or not?

Mr. COX. Well, I think I am stealing a line here, but it is free like a puppy. You get the free tax software, but then you have to pay to integrate with your other systems. And e-commerce businesses or brick and click businesses have multiple systems, not just one front end because they have got product returns, they have got, you know, out-of-State, in-State, other kinds of inventory systems. And each one, each separate module, has to have this software integrated into it.

Mr. SCOTT. Well, they have to do that for shipping.

Mr. COX. Yes. So what I am saying is that these are presently existing software modules. Now when you give me free software, I have to integrate it with my proprietary system, and that costs hundreds of thousands of dollars on average for a medium-sized business. One other thing is that——

Mr. SCOTT. Well, let me because I am running out of time.

Mr. COX. Sure.

Mr. SCOTT. A lot of companies have a presence in a lot of different States, some in all 50 States. So presumably they are collecting the tax now. Do they have audit and regulatory complications?

Mr. COX. Well, the larger a business is, obviously the larger its sales tax compliance burden. And a State that is in all 50 States it seems to me is relatively better situated in contending with these problems. No question about that.

Mr. CROSBY. Mr. Scott?

Mr. SCOTT. Yes?

Mr. CROSBY. Under the Streamline Sales Agreement, part of that is to certify and provide to sellers software that will calculate, collect, and remit tax freely to the vendor for all the States that are in the Streamline Agreement. More than 2,000——

Mr. SCOTT. Is that in existence now?

Mr. CROSBY. It is in existence now, and more than 2,000 sellers have volunteered to do that. So if the burdens were that great, they would have never volunteered to collect tax in States where they were not required to.

Mr. SCOTT. Now does that software calculate things like exemptions, food tax exemptions, and all that?

Mr. CROSBY. Absolutely.

Mr. SCOTT. And like I said, it was free. What are the costs involved in getting the software?

Mr. CROSBY. And under the Streamline Sales Tax Agreement, the States actually pay the vendors of the software to provide the software to the sellers. There may be some integration costs, but in most cases, most online vendors use commercially-available front end shopping carts. And all of the software solutions that are out there today integrate with, you know, the top 100 or 200 of the most common systems.

For some larger retailers, they may have legacy or proprietary systems, and integration costs might be higher for those. But certainly this Committee and the Congress has wide latitude to offset or mitigate those costs were it to move forward.

Mr. SCOTT. Mr. Kranz, can you say a word about what implication all of this has on foreign sellers, whether or not they would

be collecting the tax whether or not they have a presence in the United States?

Mr. KRANZ. So in terms of foreign sellers, right now the States have no ability to impose their sales tax on those companies unless they are physically present. The Marketplace Fairness Act, the Main Street Fairness Act, every version of Federal legislation that has been introduced to deal with this issue would require remote sellers located in a foreign country to collect State sales tax, just like our domestic companies do, unless you go to an origin regime. And then you are saying if you are located in France or in Russia, you do not have to collect our State sales tax.

So setting aside the origin proposal, every Federal framework that has ever been discussed on this issue would close a foreign loophole that exists today.

Mr. SCOTT. Thank you, Mr. Chairman.

Mr. GOODLATTE. Thank you. The time of the gentleman has expired. The Chair recognizes the gentleman from Ohio, Mr. Chabot, for 5 minutes.

Mr. CHABOT. Thank you, Mr. Chairman. First of all, just again to make sure that I understand, all the witnesses here have a version or have their own plan for their taxation of the internet proposals here. I do not think anybody is actually opposed to taxing the internet. Is that correct? Does anybody have the position here that we should not tax the internet at all?

Mr. CROSBY. Mr. Chabot, I might just clarify that. We are not suggesting taxation——

Mr. CHABOT. I am not talking access or anything like that. I am talking about sales only, sales tax. Does anybody have a position we should not tax sales on the internet? Okay.

Mr. SUTTON. Just about everybody at the table, if I may speak, feels that——

Mr. CHABOT. Okay. I just wanted to make that point, because we do not really have anybody here who has the position that we should not have internet sales taxes period. That is not the position of anybody here. I just wanted to clarify that.

Now, you hear the number of probably 99 percent of the internet sales taxes that are supposed to be taxed and be collected are not taxed. Does anybody refute that that is not even close, or anybody want to comment on that figure? In other words, people are supposed to pay this internet tax, they just do not. Something like 99 percent do not pay it. Does anybody say that is not accurate or not true, or we are way off there?

Mr. COX. I think that is preposterous. It is not even close to true. Seventeen of the top 20 e-retailers already collect sales taxes in 38 States, and the largest e-retailer is very soon to be collecting for two-thirds of the American population.

Mr. CHABOT. So you are saying that a lot more internet tax is collected than what people generally say.

Mr. COX. Yes, for the simple reason that you have a physical nexus rule, and the larger these internet sellers become, the more places they are. By the way, that goes to the race to the bottom question. You know, why in the world would newegg.com be in New Jersey and in California with all those people so that they

have a nexus automatically and have to collect those high in-State taxes, in those very high-tax States?

Mr. CHABOT. Mr. Crosby and Mr. Kranz, I think you want to testify. If you could make it quick because I have a couple of questions.

Mr. CROSBY. Sure, Mr. Chabot. To the extent that sales tax is not collected at the time of transaction, then you are correct. It is not collected from the consumer in almost every case. So unless the retailer is collecting the tax on the transaction, whether it occurs over the internet, catalog, or otherwise, then the use tax is unlikely to be collected unless it is a business that is involved.

Mr. CHABOT. Okay. Mr. Kranz?

Mr. KRANZ. That was my same point.

Mr. CHABOT. Okay. Thank you very much. I appreciate it. Now, the idea that I think a couple of you mentioned, the idea that the States, they would collect or it would be collected, but then they would just lower taxes in an equal amount or an equivalent amount. I find it very hard to believe that that would actually happen with the States espousing, you know, their concerns about having all kinds of things they have to pay for. And to me, this looks like another revenue source that is not being collected for the most part now. And I find it just not credible that States are going to lower taxes by the amount they collect here. Does somebody want to refute that, Mr. Moylan, because I think you were the one that said it.

Mr. MOYLAN. Well, I think I would to respond to it, that it sounds as though what you might prefer then is current law, and what current law says is if you have a physical presence in a State, you must collect its sales tax. If you do not, you do not. And, you know, personally, I do not have tremendously large problems with current law. I recognize that there are issues with it, that none of these solutions are without their potential pitfalls, and current law is no different. But I agree with you that the impulse of some States might be to try to use this as a new revenue source.

The challenge is, what is the Federal nexus with that? To what extent can the Federal Government, can Congress dictate to States what they do with their rates, and that is a very limited extent. Congress can tell them that they cannot do things that are a burden to interstate commerce, and that is what we are talking about here is trying to establish the rules on which States must operate, and then they can determine rates for themselves. But I will be right there fighting with you to make sure that they are lower than higher.

Mr. CHABOT. Thank you. I have a constituent, Allen Finer, who owns and operates a small jewelry store business. He works out of a store, and he also sells online. He sells approximately 600 items a month. According to Mr. Finer, the Marketplace Fairness Act—and again, he is talking about that, not necessarily your plans here—would force him to hire an accountant to keep up with the ever-changing nature of each State's multiple tax jurisdictions, and he says he cannot afford that time. And he says I am a small businessman. How am I supposed to handle paperwork for 9,600 different tax jurisdictions in the country? Who will pay the postage for all the forms? The extra tax I would have to collect for this leg-

islation is unfair. He has six employees. He would have to let one go to hire an accountant.

Would somebody address the concern? Mr. Crosby?

Mr. CROSBY. Mr. Chabot, yes. I understand the trepidation for him because it is not something he is dealing with today. But this Committee has great authority to craft a bill that would ameliorate those concerns or eliminate them entirely. As a jewelry store owner, jewelry is taxable in almost every State, I think probably every State that opposed the sales tax. So there is very little question as to whether the items that he is selling are taxable. So there is no taxability determination. It is very easy. It is taxable at the rate that applies.

The software that is available today, to the extent that he is selling on the internet, would be able to be integrated with a shopping cart system, would calculate the tax, would remit it to the States, could file all tax returns. And you have the ability to provide immunity for audit if he is using certified software. That is one of the things I mentioned in my written testimony.

So I think that we should not be necessarily weighed down by what is or is not in the Senate bill. You have great ability to improve that Senate product and make it work for retailers like the one you have in your district.

Mr. CHABOT. Thank you. My time is up——

Mr. COX. If I may, Mr. Chairman? Mr. Chabot, if I might just——

Mr. CHABOT. Yes, go ahead. My time has expired.

Mr. COX. I think what the jewelry store is telling you, the 600 items a month jeweler, is that it is not the tax that he is worried about as a merchant. It is the compliance burden, which we should also think of as a tax, and it is a much bigger problem. That is what is at issue here, and I think you tee'd that up with your first question. It is not really about the competitive differential of collecting the tax. There is much less objection to that than there is to taking on this compliance burden.

And with respect to how the software is going to make all of this so simple, it is easy unless it is not. I was just speaking with a merchant in Philadelphia who sells American flags. And this is like the Florida stories you were telling. This is just intrastate. This is not even, you know, having to deal with the whole country.

So they came after him for back taxes for sales taxes because he thought there was an exemption for American flags. They said, how many stars on this flag? And he said 48. How many stars are on this flag? And he said 13. They said, well, you know that the exemption is only for 50-State flags. And he said, no, how am I supposed to know this? And they said, well, you know, it is your responsibility as the taxpayer. He said, is it in the published regs? No. Well, where is it? It is in decisional law. Well, can I look that up? Well, no, but you can subscribe to a service and then you would know. And he said, well, thank you. Now I know and I will do it right next time, and they said, oh, no, no, no, you owe all of these back taxes, and it almost bankrupted his business.

Now, if the software vendor does not have that in its list, and I am sure they do not, then they are going to say, well, it is not our fault, and then you get the right to litigate, and how expensive

is that? So those are the burdens we are talking about, and those are the burdens that we have to worry about.

Mr. MOSCHELLA. Mr. Chairman, can I——

Mr. GOODLATTE. The time of the gentleman has expired. We will allow Mr. Moschella——

Mr. MOSCHELLA. Just 15 seconds.

Mr. GOODLATTE. Very brief.

Mr. MOSCHELLA. These same arguments were made when Congress considered the 21st Amendment Enforcement Act in 2000. And you know what? The vendors and others who are concerned changed and adapted and are complying and remitting State sales taxes all over the United States.

Mr. GOODLATTE. The gentlewoman from California, Ms. Lofgren, is recognized for 5 minutes.

Ms. LOFGREN. Thank you, Mr. Chairman, and thanks for having this hearing. I think as we listen to this, it becomes clear that this is not a simple issue. And if it were, it would have been solved a long time ago. Looking at the audience here today, I see Randy Fries, and I mentioned him because one of my favorite stores in the entire world is Fries. I was there over the weekend.

And, you know, that is an example of why this is important to brick and mortar stores because we want to make sure that there is an even playing field so that stores like that can flourish. I am actually of the belief that in order to have a tech economy, you have to have Fries in your county.

On the other hand, I have recently talked to a woman who is a former tech worker, engineer, who retired. And before the Affordable Care Act, her 20-something son got cancer, and she ended up spending every penny she had, everything she had saved. She sold her house to get medical care to save her son's life, and she actually succeeded in that. But she ended up being, you know, in her late 60's with not a dime to her name. And she ended up starting a little small business. It is an e-business. And she is, you know, very concerned that, you know, with the kind of small margin she has and just barely supports herself that she would have something complicated that she could not survive in her e-business. And that is important, too.

So, you know, as I am thinking about this, I had just thought all along that if we did something, that we should have a huge, you know, robust exemption for small businesses to take care of ladies like that woman who saved her son. But there has now been this discussion of having something that is so simple that you would not even need a small business exemption.

But it turns out that is not so simple either, I think. You know, as I am thinking about having one rate per State, you know, I was in county government, as was the gentleman from Ohio. And one of the things that we did in Santa Clara, or actually our voters did, was to repeatedly increase their own sales tax by a vote of the people for various projects—for public health, for the county hospital, to improve rail transit, to build highways.

How would you deal with voter approved sales tax in cities or counties if you had one rate per State on these sales taxes? How would that work? Does anybody have some guidance on that?

Mr. KRANZ. Well, I think it creates a practical legal process problem for States to participate. A one rate proposal was discussed long, long ago, and rejected not only because of that practical legal process problem, but as Mr. Crosby testified earlier, a one rate proposal forces a tax increase in at least half of the jurisdictions. You have got to get to a common denominator.

So unless you want to force a tax increase, a one rate proposal is dead on arrival before you even get to the legal process questions about how to implement it at the local government level when those decisions about tax rates are made either by votes of people, or city councils, or county boards, or other process problems that would be faced. So it was considered and rejected very early on in the last 15-year discussion.

Ms. LOFGREN. But it is being discussed again today. And, you know, I really want to do something that works. I understand that the growth of online retail is far exceeding the growth of brick and mortar retail. That is important to me, and I think it is important to the commercial sector of the United States.

On the other hand, I really am very skeptical that it is possible to control choosing jurisdictions to avoid tax. I mean, if you are an e-retailer, you have a lot of options to locate and to avoid retail tax. Would that not essentially create incentives for businesses to move to sales tax jurisdictions, and would that not actually further impede the growth or the prosperity of brick and mortar businesses? Mr. Kranz, do you have a comment on that?

Mr. KRANZ. Well, I think an origin system would cause a complete upheaval in the retail community because it is so easily manipulated. I am not an economist, and I cannot predict exactly what that upheaval would look like. An origin system taxes production and says we want to tax you if you are producing and selling from here. Well, who wants to locate their business there?

Ms. LOFGREN. Right.

Mr. KRANZ. They are going to move. Our sales tax system in this country has always been a tax on consumption and the proposals——

Ms. LOFGREN. If I may, and I know my time is up, but this is complicated. Recently somebody said in addition to the voter approved sales tax, I mean, you have got, like, Monday is a holiday for school clothes in county X. I mean, to say that we are going to be able to accommodate all of that stuff by software, I am sorry, I am pretty skeptical. And it is not just the software, it is the audit exceptions that need to be accommodated especially for small retailers.

I see my time is up, Mr. Chairman. I yield back.

Mr. GOODLATTE. The Chair thanks the gentlewoman, and recognizes the gentleman from Alabama, Mr. Bachus, for 5 minutes.

Mr. BACHUS. How many of you all agree with the term or the statement that "the best government is a government closest to the people?" Could we just have a show of hands?

[Hands raised.]

Mr. BACHUS. All right. So that is unanimous. I agree with you that the best government is a government closest to the people. When I look at services that I absolutely have to have, other than

national defense, it is schools, it is police protection, fire protection, sanitation, water, roads. And that is State and local government.

Since I have been a Member of Congress, I have State and local governments come to me and say we need a new fire truck. We need some help paying our police officers. We cannot afford to bring water to this community. And, you know, I have thought, you know, there is something wrong with this.

Why have we made them dependent on the Federal Government? Why do they have to come 700 miles to get funding? And I will tell you what it is. The same thing. I was a State senator, and I was on the State school board, and I ran for Congress for one reason. Two-thirds of the money when Harry Truman was President stayed in the local communities and the States. Less than a third came to Washington. Today two-thirds of the money comes up here, so everybody has to come up with their hand out, and that is demeaning. And I said we ought to reverse that. Ronald Reagan campaigned on that. Barry Goldwater campaigned. Let us put these things back in the States. Both recognized we have to allow them to collect the taxes there.

Now, Mr. Malone?

Mr. MOYLAN. Moylan.

Mr. BACHUS. Moylan. You have actually almost, to me, proposed a system that is totally backwards. First of all, you said they were theoretical taxes. Is that what your testimony was?

Mr. MOYLAN. The testimony is that it theoretically falls on the individual, but that the administrative burden, the legal burdens, falls on the business.

Mr. BACHUS. Well, if I buy a new car over the internet and I do not pay sales tax, and the State of Alabama comes to me and says you did not pay the tax, could I say that was theoretical?

Mr. MOYLAN. Well, no. That would actually be enforced when you register and title the vehicle. That is one area where business tax works quite well.

Mr. BACHUS. But could I hide behind that? If I did not pay taxes on something I bought out-of-State, could I assert that in court that it really was not legally owed?

Mr. MOYLAN. No, and actually you make a very good point that use tax really is an individual tax. Use taxes are due from the individual, and that is the problem is that they are not administered——

Mr. BACHUS. A sales tax is not on the seller. It is on the buyer.

Mr. SUTTON. That is not correct in most States. Sales tax is an excise tax. It is imposed in most States on the right to exercise your right to sell property.

Mr. BACHUS. Well, what I am saying, if I buy something on the internet, do I not pay the tax?

Mr. CROSBY. In all of those States it is also mandated to be passed through to the consumer. So certainly the business collects, but, you know, my employer collects——

Mr. BACHUS. They are a conduit.

Mr. CROSBY [continuing]. Social security tax, my personal income tax, my Federal income tax. My mortgage company collects my property tax.

Mr. BACHUS. Sure.

Mr. CROSBY. I am paying those taxes.

Mr. BACHUS. Sure. I mean, this idea that the seller is paying is just—I mean, I am responsible for them.

Mr. MOYLAN. It is a question of who the legal burden to comply with that obligation falls on.

Mr. BACHUS. Well, okay, let me ask you——

Mr. MOYLAN. And all of the ones that Joe just pointed out, the burden falls on the individual.

Mr. BACHUS. Let me say this. Everybody here has got a different plan. You have got a plan, you know. Mr. Moschella, you have got a plan. But why would we as the Federal Government try to make that decision for every city and every county and every State? Is that not kind of arrogant?

Mr. SUTTON. That is the beauty of the consumer private reporting system. We let them make those decisions. We give them the information, and then we let them do with it what they will.

Mr. BACHUS. Well, Mr. Moylan, he is actually proposing something that would prevent them from collecting their own taxes. I mean, that is pretty radical. I have never——

Mr. MOYLAN. If I may speak for myself.

Mr. BACHUS. Has the Congress of the United States ever passed a law prohibiting a local government from charging a sales tax?

Mr. MOYLAN. What I am proposing——

Mr. BACHUS. No, I am just asking have they ever done that. Do you know of one case?

Mr. MOYLAN. The point of your question, it seems to me, is to get at——

Mr. BACHUS. No, no, the point—I am just saying, I mean, is that not a pretty radical idea for me as a congressman to pass your origin sourcing and tell every city, and every county, and every State that they could not collect a sales tax?

Mr. MOYLAN. It is only as revolutionary as what already exists for the vast majority of sales today.

Mr. BACHUS. Well, I am saying we have never done it before. Has any State or any other country, to your knowledge, ever, ever proposed this on a cross-border sale?

Mr. MOYLAN. Has any place used origin sourcing? Certainly.

Mr. BACHUS. In cross-border. Texas you said, but they do not do it on interstate——

Mr. MOYLAN. There is one example that I utilized in my written testimony, that the European Union utilizes origin sourcing for business to consumer sales.

Mr. BACHUS. Okay. So you want to go to that. You want to go to that.

Mr. MOYLAN. Well, they did it for administrative simplicity.

Mr. BACHUS. No, that is all right.

Mr. MOYLAN. But I wanted to respond to——

Mr. BACHUS. We do not do that in the United States.

Mr. MOYLAN. I wanted to respond to one point that you were getting at earlier, and it sounded like you were expressing concern about the erosion of the sales tax base. And I do not think that it is wrong to have concerns about the erosion of the sales tax base. What I would say is that——

Mr. BACHUS. Well, actually what I am concerned about——

Mr. GOODLATTE. The time of the gentleman has expired. We will allow the gentleman to answer the question. The time of the gentleman has expired.

Mr. BACHUS. And could I tell him—well, actually we have gone over 10 minutes on——

Mr. GOODLATTE. No, we have not gone over anywhere close to 10 minutes. We have been watching very closely.

Mr. BACHUS. Oh, okay. Well, I will let him answer.

Mr. GOODLATTE. The gentleman is over a minute now. But I would want him to answer the question.

Mr. BACHUS. But that is not my concern. My concern is that if I buy something in Washington, I do not want to pay Washington State. I want to pay, you know, Homewood where I live.

Mr. MOYLAN. Well, then it sounds like——

Mr. BACHUS. Because that is where my kids go to school. That is who——

Mr. GOODLATTE. The time of the gentleman has expired. The Chair recognizes the gentleman from Georgia, Mr. Johnson, for 5 minutes.

Mr. JOHNSON. Thank you. Thank you, Mr. Chairman. I would ask unanimous consent to place into the record the following materials in support of collecting online sales taxes. One is a letter from the Streamline Sales Tax Governing Board* explaining the key components of the Streamline Sales and Use Tax Agreement. Also resolutions from the cities of Cave Spring, Rome, Thomson, and Vienna, Georgia describing the positive impact of remote sales tax collection on local economies in Georgia. And last, but not least, a letter from the Liberty County Chamber of Commerce noting that the Marketplace Fairness Act would strengthen the economy and allow greater transparency with the tax code. I would ask that these be considered and put into the record.

Mr. GOODLATTE. Without objection, they will be made a part of the record.

[The information referred to follows:]

*Material previously submitted, see page 9.

CITY OF CAVE SPRING, GEORGIA

Resolution for Marketplace Fairness Act (S336 and HR684)

Whereas, strong local economies are built on strong local businesses; and

Whereas, Georgia's local businesses create jobs and economic activity that generate sales taxes to pay for schools, public safety, and public infrastructure while helping to keep property taxes low; and

Whereas, Main Street retailers in Georgia have been hurt in recent years by online and catalog purchases by customers who believe they receive a discount by not paying sales tax; and

Whereas, the brick-and-mortar retailer collects the sales tax at the time of purchase in a store, but the responsibility for paying the tax from an online purchase shifts to the Internet customer who should pay the sales tax when filing his annual income tax returns; and

Whereas, most taxpayers are not aware of the responsibility to remit these taxes; and

Whereas, local businesses in the City of Cave Spring and Floyd County, Georgia are at a 6% competitive price disadvantage to remote sellers; and

Whereas, the Supreme Court decision in *Quill Corp. v. North Dakota*,504 U.S. 298 (1992), left state and local governments unable to adequately enforce their existing sales tax laws on sales by out-of-state catalog and online sellers; and

Whereas, the Court did state that Congress had the constitutional authority to pass legislation overruling its decision; if Congress acts to regulate interstate commerce, state and local governments could collect taxes owed on Internet and mail order sales amounting to $23 billion; and

Whereas, in Georgia, the estimated uncollected state and local sales and use taxes from all remote sales in 2012 was $837,610,389; and

Whereas, the Act would only grant authority to collect taxes on remote sales to states that simplify their sales tax laws in order to ease compliance; and

Whereas, the State of Georgia is recognized as a Streamlined Sales Tax state and is a full member of the Streamlined Sales Tax Governing Board; and

Whereas, economic research has shown that the elimination of the current tax loophole on internet sales would create jobs and create economic activity nationwide, creating an estimated 31,000 new jobs in Georgia; and

Whereas, by ending this unequal tax treatment, which tends to distort market forces, a more competitive, pro-growth and level playing field would be created; and

Whereas, in addition to leveling the playing field between online merchants and brick-and-mortar retailers, passage of the MFA would also help Georgia and its communities make needed investments in schools, infrastructure, public safety and other quality-of-life issues that help create a healthy economic environment.

Now, therefore, Be It Resolved that the City Council of Cave Spring, Georgia does hereby urge all members of the Georgia Congressional delegation to take action in 2013 to approve the Marketplace Fairness Act (S336 and HR684) which will level the playing field for local businesses by allowing individual states the authority to collect sales taxes directly form online retailers.

Be It So Resolved, this 10th day of December, 2013.

ROB WARE, Mayor

ATTEST:

JUDY DICKINSON, Clerk

City of Rome

Whereas, strong local economies are built on strong local businesses; and

Whereas, Georgia's local businesses create jobs and economic activity that generate sales taxes to pay for schools, public safety, and public infrastructure while helping to keep property taxes low; and

Whereas, Main Street retailers in Georgia have been hurt in recent years by online and catalog purchases by customers who believe they receive a discount by not paying sales tax; and

Whereas, the brick-and-mortar retailer collects the sales tax at the time of purchase in a store, but the responsibility for paying the tax from an online purchase shifts to the Internet customer who should pay the sales tax when filing his annual income tax returns; and

Whereas, most taxpayers are not aware of the responsibility to remit these taxes; and

Whereas, local businesses in the City of Rome and Floyd County, Georgia are at a 6% competitive price disadvantage to remote sellers; and

Whereas, the Supreme Court decision in *Quill Corp. v. North Dakota*,504 U.S. 298 (1992), left state and local governments unable to adequately enforce their existing sales tax laws on sales by out-of-state catalog and online sellers; and

Whereas, the Court did state that Congress had the constitutional authority to pass legislation overruling its decision; if Congress acts to regulate interstate commerce, state and local governments could collect taxes owed on Internet and mail order sales amounting to $23 billion; and

Whereas, in Georgia, the estimated uncollected state and local sales and use taxes from all remote sales in 2012 was $837,610,389; and

Whereas, the Act would only grant authority to collect taxes on remote sales to states that simplify their sales tax laws in order to ease compliance; and

Whereas, the State of Georgia is recognized as a Streamlined Sales Tax state and is a full member of the Streamlined Sales Tax Governing Board; and

Whereas, economic research has shown that the elimination of the current tax loophole on internet sales would create jobs and create economic activity nationwide, creating an estimated 31,000 new jobs in Georgia; and

Whereas, by ending this unequal tax treatment, which tends to distort market forces, a more competitive, pro-growth and level playing field would be created; and

Whereas, in addition to leveling the playing field between online merchants and brick-and-mortar retailers, passage of the MFA would also help Georgia and its communities make needed investments in schools, infrastructure, public safety and other quality-of-life issues that help create a healthy economic environment.

Now, therefore, Be It Resolved that City Commission of Rome, Georgia do hereby urge all members of the Georgia Congressional delegation to take action in 2013 to approve the Marketplace Fairness Act (S336 and HR684) which will level the playing field for local businesses by allowing individual states the authority to collect sales taxes directly form online retailers.

Adopted this 23rd day of SEPT., 2013

Evie McNiece
Mayor

Joe Smith
Clerk

The McDuffie Progress
Wednesday, September 4, 2013

City council approves resolution to collect sales tax from online retailers
The lack of paying sales tax by consumers making online purchases has become problematic for numerous retailers across Georgia.

It has been estimated that in 2012 uncollected state and local sales and use taxes from all remote sales across the state was $837,610,389.

According to a resolution approved by the Thomson City Council Thursday, businesses in Thomson and McDuffie County are at a seven percent competitive price disadvantage to remote or online retailers.

The resolution, called the Marketplace Fairness Act, encourages the passage of a federal law that will allow individual states to collect sales tax from online merchants.

"We in this county are missing some sales tax dollars," said Thomson Mayor Kenneth Usry, adding that legislators who represent McDuffie County have been made aware of the resolution.

Georgia passed a law in 2012 in an attempt to force web sellers to collect sales tax on purchases. The Georgia Department of Revenue acknowledges that a Use Tax should be received on purchases made through the internet, via mail order, or from an out-of-state company when Georgia sales tax is not collected by the selling company. The use tax rate is the same as the sales tax rate imposed in the Georgia county of delivery.

Usry, who serves on the Georgia Municipal Association's policy and legislative committees, said there is an effort underway to get all states to push for fairness in sales tax collections between online retailers and brick and mortar merchants.

The online giant Amazon.com, responding to the Georgia's law began collecting sales tax on purchases from Georgia residents on Sept. 1.

The Thomson City Council unanimously approved the resolution urging Georgia's Congressional Delegation to approve the Act, which is S336 and HR684 to allow states the authority to collect sales tax directly from online retailers.

City of Vienna
203 West Cotton Street
Post Office Box 436
Vienna, Georgia
(229)268-4744

Resolution for Marketplace Fairness Act (S336 and HR684)

Whereas, strong local economies are built on strong local businesses; and

Whereas, Georgia's local businesses create jobs and economic activity that generate sales taxes to pay for
schools, public safety, and public infrastructure while helping to keep property taxes low; and

Whereas, Main Street retailers in Georgia have been hurt in recent years by online and catalog purchases by customers who believe they receive a discount by not paying sales tax; and

Whereas, the brick-and-mortar retailer collects the sales tax at the time of purchase in a store, but the responsibility for paying the tax from an online purchase shifts to the internet customer who should pay the sales tax when filling his annual income tax returns; and

Whereas, most taxpayers are not aware of the responsibility to remit these taxes; and

Whereas, local businesses in the City of Vienna and Dooly County, Georgia are at a 8% competitive price disadvantage to remote sellers; and

Whereas, the Supreme Court decision in Quill Corp. v. North Dakota, 504 U.S. 298 (1992), left state and local governments unable to adequately enforce their existing sales tax laws on sales by out-of-state catalog and online sellers; and

Whereas, the Court did state the Congress had the constitutional authority to pass legislation overruling its decision; if Congress acts to regulate interstate commerce, state and local governments could collect taxes owed on internet and mail order sales amounting to $23 Billion; and

Whereas, in Georgia, the estimated uncollected state and local sales and use taxes from all remote sales in 2012 were $837,610,389; and

Whereas, the Act would only grant authority to collect taxes on remote sales to states that simplify their sales tax laws in order to ease compliance; and

Whereas, the State of Georgia is recognized as a Streamlined Sale Tax state and is a full member of the Streamlined Sales Tax Governing Board; and

Whereas, economic research has shown that the elimination of the current tax loophole on internet sales would create jobs and create economic activity nationwide, creating and estimated 31,000 new jobs in Georgia; and

Whereas, by ending the unequal tax treatment, which tends to distort market forces, a more competitive, pro-growth and level playing field would be created; and

Whereas, in addition to leveling the playing field between online merchants and brick-and-mortar retailers, passage of the MFA would also help Georgia and its communities make needed investments in schools, infrastructure, public safety and other quality-of-life issues that help create a healthy economic environment.

Now, therefore, Be it Resolved that the Mayor and Council of the City of Vienna, Georgia do herby urge all members of the Georgia Congressional delegation to take action in 2013 to approve the Marketplace Fairness Act (S336 and HR684) which will level the playing field for local businesses by allowing individual states the authority to collect sales taxes directly form online retailers.

Be It So Resolved, this 23 day of September 2013

Attest: Paula B. Bembury
City Clerk

Mayor

Date: 9/24/2013

Liberty County
CHAMBER OF COMMERCE

As an integral part of the business community in Liberty County, the Liberty County Chamber of Commerce (LCCOC) has taken an official position in favor of two key pieces of legislation. During the last board meeting, the LCCOC Board of Directors considered the legislation for the Georgia Full Accountability in Collection Taxes (FACT) Act of 2014 and the Marketplace Fairness Act of 2013. The Board voted to support both bills.

Both pieces of legislation will affect business on the local level and the Chamber Board of Directors believes it is important to provide our official stance and offer insight to the community regarding the decision.

The FACT Act, House Bill 713, proposes an increase in transparency in the reporting of sales and use tax. The premise is to allow local governments to have a better idea as to where revenues are derived. This legislation would allow the Georgia Department of Revenue to share sales tax information with a local government official and all sales tax information to be shared in executive session if necessary, while ensuring that the information retains its confidential nature.

The local government will also be allowed to research sales and use tax errors, underreporting of sales and use taxes, misuse of sales and use tax exemptions and fluctuations in distributions amounts. In addition, it will forbid local government to contact any taxpayer identified in confidential information.

Currently, the bill is waiting to go through the House Ways and Means Committee.

Additional information can be found at http://www.legis.ga.gov/legislation/en-US/Display/20132014/HB/713 or http://www.daily-tribune.com/view/full_story/24492408/article-Battles-sponsors-FACT-Act-for-tax-transparency.

The second bill is a federal bill known as the Marketplace Fairness Act (S.336/H.R.684). It grants the states the authority to compel online and catalog retailers, regardless of their location, to collect sales tax at the time of the transaction. Local retailers are already required to collect sales tax and the Marketplace Fairness Act would make that same requirement of online retailers.

The Marketplace Fairness Act is not a new tax. Currently, online sellers must collect sales tax from customers in their own states. However, a 1992 decision by the Supreme Court makes it so that retailers do not always have to collect. The Marketplace Fairness Act, which has already been passed by the U. S. Senate, holds online retailers to the same tax collection standard as brick and mortar local retailers.

By supporting the Marketplace Fairness Act, the LCCOC joins over 300 organizations that support the legislation, including Amazon, one of the world's largest online retailers.

Additional information can be found at http://thomas.loc.gov/cgi-bin/query/D?c113:14:./temp/~c113Sq5K16 or http://thomas.loc.gov/cgi-bin/query.

The Chamber Board did extensive research and reading on this issue and felt that supporting this legislation was a positive step. We believe that if passed, these pieces of legislation will strengthen the economy and allow greater transparency within the tax code. The Chamber Board is made up of small business owners, some who sell out of state; bankers, realtors, service providers, those in the medical profession, retailers and more.

-Liberty County Chamber of Commerce Board of Directors

Mr. JOHNSON. And, Mr. Chairman, I thank you for holding this hearing today. Uncollected tax sales are costing us billions of dollars at a time when States' budgets are slimmer than ever. According to a study from the University of Tennessee, States sustained over $52 billion in losses from uncollected taxes on e-commerce sales between 2007 and 2012.

In 2012 alone, the most difficult budget on record for many States, roughly $23 billion in State sales taxes were uncollected. I imagine that is really tough on those States that have no income tax and rely largely on sales taxes for their revenues. And according to conservative economic theorist, Arthur Laffer, closing the online sales tax loophole in my State of Georgia would generate over $50,000 new jobs and over $15 billion in additional GDP by 2022.

Passing common sense legislation like the Marketplace Fairness Act would result in lower taxes as it in has in Georgia. What is more, States across the country could expand social programs to help our hungry, sick, and poor while also having much needed revenue to build countless schools, roads, bridges, and other infrastructural projects that put Americans back to work.

Mr. Chairman, we need a solution to this tax loophole that needs to be closed. An even-handed approach like the Marketplace Fairness Act would protect consumers' privacy, avoid headaches and consumer surprise, and ensure compliance costs are minimal. Unlike some alternatives that this Committee will contemplate in today's hearing, internet sales tax legislation would make sales and use taxes more efficient and avoid program administration problems. But I am open to new proposals that tackle this issue in an even-handed way because it is time that we solve this crisis.

The Committee has held numerous hearings on the issue. We understand the problem, and we know that we need to fix it. The Senate has already reported legislation that is overwhelmingly bipartisan, and it is time for this Committee to follow suit. As the Ranking Member of the Subcommittee, I look forward to working together with you to get this done.

Now, I would say that State governments rely on sales and use taxes for nearly 31 percent of their total revenue. And most of this revenue is collected by retailers at the point of sale in the form of a sales tax based on the retailer's presence in the State. For sales, when the retailer is not present in the State, a use tax would be owed by the consumer. But that places undue burdens on the consumer to pay the tax, and at this point, only 1 percent of those taxes are collected.

And so, this Marketplace Fairness Act would make it simple for consumers to be able to contribute to the economies of their States and their local governments as well. And so, for the things that my Chairman, Mr. Bachus, mentioned—police, fire, hospitals, roads, education—those things, those are State expenditures that are hurt. We cannot provide those services if the revenues are not there. And if we let this play out to its logical extreme, brick and mortar will go away, and all transactions will be done via internet. And if we do not correct this right now, there will be no taxes collected on transactions.

So with that, I will yield back, Mr. Chairman.

Mr. GOODLATTE. The Chair thanks the gentleman, and recognizes the gentleman from Iowa, Mr. King, for 5 minutes.

Mr. KING. Thank you, Mr. Chairman. I thank you and the witnesses for this hearing we are having today. It looks to me like there are several of you that have lived this for a long time, and there is a lot of expertise at the table.

I am curious. First, I would turn to Mr. Crosby. In your testimony you said there are 17 consecutive double digit quarters of e-commerce increase. And so, can you tell me at this point then what percentage of the taxable commerce goes to e-commerce?

Mr. CROSBY. According to the most recent census, the unadjusted figures are that 7 percent of all retail commerce is now e-commerce.

Mr. KING. Seven percent.

Mr. CROSBY. Correct.

Mr. KING. And 10 years ago, what was that?

Mr. CROSBY. .7 percent.

Mr. KING. Okay. And is there a projection on where that takes us in 10 years?

Mr. CROSBY. It will continue to increase. I do not think——

[Laughter.]

Mr. KING. Okay. We can project out however we like at that percentage a year. That is a smaller number than I expected. I expected it would give me a little bit more heartburn than it actually does. But can you tell us how many different sales tax districts there are in the United States?

Mr. CROSBY. Sure. There are about 9,600 sales taxing districts in the United States. Many of those are local governments, county governments, or different districts for special purposes, as Ms. Lofgren talked about.

Mr. KING. And it was curious to me that some of her track of thought was tracking the same path that I was following on that. And so, when you look at all of these districts, I mean, how often do you anticipate one would need to upgrade their software with these 9,600 districts that could potentially be changing their tax rates at any time?

Mr. CROSBY. One of the components of most of the pieces of legislation that have been introduced would restrict how frequently State and local governments could change their tax rates or their tax bases to a calendar quarter to make it easier for software companies to keep up. They do so today.

Mr. KING. They could upgrade once a quarter under that proposal?

Mr. CROSBY. Correct, and they do so today. They can keep up. Certainly it would be easier if it were restricted to quarterly.

Mr. KING. I would like to mention to the Committee my view on this. But first, before I forget to do so, I have a letter from Governor Terry Brandstad that essentially says that he is in general support of the Senate version of the bill, and he would take any tax revenue that came to Iowa and convert that into tax deductions, similar to Governor Scott Walker. I would ask unanimous consent to introduce this letter into the record.

Mr. GOODLATTE. Without objection, it will be made a part of the record.

[The information referred to follows:]

Terry E. Branstad
GOVERNOR

OFFICE OF THE GOVERNOR

Kim Reynolds
LT. GOVERNOR

June 12, 2013

The Honorable Steve King
2210 Rayburn Office Building
Washington, DC 20515

Dear Congressman King:

The U.S. Senate recently passed The Marketplace Fairness Act of 2013, S. 743 (Marketplace Fairness), by a large bipartisan margin. I understand that the U.S. House Judiciary Committee may soon take up the issue.

The legislation would stop picking winners and losers through disparate enforcement of sales taxes for brick and mortar retailers versus online retailers – ultimately leveling the playing field between Iowa's small businesses and large online businesses. The Iowa Department of Revenue estimates that the U.S. Senate's Marketplace Fairness Act could result in approximately $18 million in additional sales tax revenue annually. I have no interest or intent in growing the size of the State government with these new revenues – on the contrary, I would work with the Legislature to use the new revenues to provide an offset for state-based tax relief.

As you may be aware, I recently signed into law the largest tax relief package in the State's history with the enactment of significant property tax reforms and other tax reduction measures. The State's tax relief efforts will improve Iowa's competitiveness compared to other states and our work to provide state-based tax relief is not complete. I want to be transparent in my intentions regarding any additional revenues if the Marketplace Fairness legislation ultimately becomes law -- I intend to utilize any related revenue that the State would receive to enable further tax relief to Iowans, including income tax reductions. Such reductions would help stretch family incomes, create jobs, and increase our competitiveness compared to other states.

Governors from across the country support this legislation because it provides an opportunity for Federal leaders to enact an equitable solution that allows for a predictable, simple, and streamlined approach for states to consistently enforce sales tax laws. Simply put, this legislation 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. I join governors of both parties and a bipartisan group of US Senators in support of this legislation.

If I can provide any additional assistance, please contact me, or Doug Hoelscher, Director of State-Federal Relations for the State of Iowa.

Sincerely,

Terry E. Branstad
Governor of Iowa

STATE CAPITOL DES MOINES, IOWA 50319 515-281-5211 FAX: 515-725-3528

Mr. KING. Thank you, Mr. Chairman. And then just to lay out my position here is that I believe that it is just and it is equity to collect sales tax for sales, whether they are brick and mortar, or whether they are click, and whether they are foreign sale as well. And I would like to see a balance and a level playing field, and I would like to see equity in this text, but I have got to have the simplicity that is there, too.

And the one thing that came to me that impressed me more than anything else was the complexity that could be visited upon someone who was in internet sales and catalog sales that had multiple sales in a higher percentage of these 9,600 taxing districts. I mean, it looks to me like that complexity and the changing notion of that, even though we have software, gets to be too high a burden on our retailers.

I would go back to Mr. Kranz and say I did not quite understand with full clarity your response to Ms. Lofgren. If the Federal Government engaged in this regulation only with regard to a single tax rate for each State and let the States then figure out the distribution within their borders, was that part of the discussion that 15 years ago was rejected?

Mr. KRANZ. It was, and, again, it was because of the fear that it forces a tax rate increase for all the lower jurisdictions. So the conclusion at the end of the debate of is one rate per State the right answer was, no, in today's modern economy there should be an app for that. There should be software that can do it. And, in fact, there——

Mr. KING. But how does it force a tax rate on a State? I mean, I was in the State legislature. All taxing jurisdiction that is inside the State of Iowa is authorized by the Iowa General Assembly. And so, they have that choice, but they grant the taxing authority to the jurisdictions. So it really does not exist unless it is granted by the State. Would you respond to that?

Mr. KRANZ. In some States, that is right. The local ability to impose tax and determine tax rates is granted by the State legislature. In other States, in Colorado, for example, the locals have what is called home rule authority. They have Colorado constitutional rights to set their own rates. They do not need the legislature's approval.

Mr. KING. My time is running out, and so I would like to say this. I want to thank Mr. Moschella for giving me the Bowman case. I think I can find another case that that is on point on. I will catch up with you on that a little bit later.

But I wanted to let the Committee know that I am concerned about how we get this right because one day I want to abolish the entire Federal income tax code and replace it with a national consumption tax. And if we get this right, it helps lay the foundation for H.R. 25, the Fair Tax Act. And so, I am focused on this more than I might otherwise, but it is very important to this country to get this right. And I want to protect our brick and mortar people, and I want to allow e-commerce to expand. I want to do it with simplicity and not with over-burdened Federal regulations.

So thanks for all your efforts and your focus on this. It has been an excellent panel. Mr. Chairman, I yield back.

Mr. GOODLATTE. The Chair thanks the gentleman, and recognizes the gentlewoman from California, Ms. Chu, for 5 minutes.

Ms. CHU. Thank you, Mr. Chair. Mr. Kranz, I have a question for you, but I would like to make some comments first. Before I came to Congress, I was on the California Board of Equalization, which is our country's only elected tax board, and administered the sales and use tax. So I can personally speak to the dramatic decline of sales tax revenue due to the increase in sales online which go uncollected.

And in my State of California, it is estimated that over $1 billion of use tax remains uncollected. The figure is expected to grow. I felt that the current system for collecting use tax was one of the most inefficient that I have ever seen. Very few people know that such an obligation even exists. In fact, they are downright shocked when you talk about it. And at the Board of Equalization, we had an army of auditors hunting for use tax obligation. But with all our efforts, we only collected 1 percent of the entire use tax owed.

And in addition, we see more businesses closing their doors on Main Street. Radio Shack is closing 1,100 stores throughout the country. We just cannot wait to pass legislation. And, in fact, I am an original co-sponsor of the Marketplace Fairness Act.

And so, Mr. Kranz, we have heard five proposals today. Could you please rate them from the least to the most viable and explain why? [Laughter.]

Mr. KRANZ. That is your job. [Laughter.]

Well, I would say that my view of the two origin sourcing proposals and the reporting regime, they should be non-starters because they really are not efforts to fix our country's sales tax system. They are efforts to go in an entirely different direction and create a whole new burden and regime, and create all kinds of problems as a result.

Mr. Moschella's proposal is a novel proposal. It says, okay, if you do not want to collect sales tax, we are putting a fence around each State. There is a border that you cannot cross unless you collect the tax. It is novel, but I do not think Congress should be in the job of putting fences around the States.

The only real alternative is as Mr. Crosby suggested, a Federal framework that provides simplification, uniformity, and technology, and protects remote sellers from what is happening at the State level, and the attacks that remote sellers are under.

It is your job to decide how much simplification, how much uniformity, and what kind of technology that bill would include. The Marketplace Fairness Act in the Senate is a version. Earlier versions of the bill had lots of different requirements, and a bill could be fashioned that provided the right level of protection to remote sellers while guaranteeing a level playing for brick and mortars and a stable revenue source for the States.

Ms. CHU. And there was another proposal that you did not mention, which had to do with the reporting. Why is that not as viable of a way of collecting the use tax?

Mr. KRANZ. Well, again, it is not a tax regime. It is an obligation on sellers saying, well, you do not have to collect sales tax or use tax, but you need to build in a whole new type of software that does not exist today. There needs to be a federally created database

and repository for all of this information about what consumers are purchasing in each State. And then there needs to be a mechanism to share that information with the States to allow them to go out and audit consumers.

Now, do we really want to walk away from our sales tax system and create this burdensome new regime to capture data, and store it somewhere, and transmit it to the States, and allow them to audit consumers instead of simply requiring remote sellers to collect tax under a logical set of rules? I do not think that that is what is in our economy's best interest.

Ms. CHU. You talk in your testimony about the consequences of inaction. You talk about increased litigation and increase on certainty for remote sellers and consumers. Could you expand on that?

Mr. KRANZ. The consequences of inaction, we saw this in the 1980's with the National Bellas Hess Project. The States got tired of waiting for Congress. They are getting tired again today. And rather than focusing on simplification and streamline and uniformity, as the Chairman asked me at the very beginning, are they walking away from simplification? Well, 17 States have said if Congress is not going to reward us for simplification, we are going to fix this on our own. That to me is the real threat to the economy is State by State inconsistency and burdensome approaches targeting very specifically e-commerce business models.

And when you have that kind of approach, it raises constitutional questions. There will be litigation, and there is already litigation popping up around the country as a result of that State self-help. I do not think it is healthy for our economy as well.

Ms. CHU. Thank you, and I yield back.

Mr. GOODLATTE. The Chair thanks the gentlewoman, and recognizes the gentleman from Utah, Mr. Chaffetz, for 5 minutes.

Mr. CHAFFETZ. Thank you. Thank you, Chairman, and thank you for taking——

Mr. GOODLATTE. I apologize. I did not see that Mr. Franks had arrived back, and so I am going to go to him first. Last week I overlooked him all together. So today he goes first, and then we will come back to you after we go to him. [Laughter.]

Mr. FRANKS. I will assure you——

Mr. GOODLATTE. I apologize to both of you.

Mr. FRANKS [continuing]. It is definitely a plot, and so—— [Laughter.]

No, I appreciate it so much, and sorry about that, Jason. The people probably would have appreciated your questions more, so you will probably be next.

But in any case, Mr. Chairman, I think all of us on this Committee recognize that the sales tax that should be collected by internet providers or companies on the internet sometimes is not done as consistently as it should be. And we recognize that there is an inequity there, that some of the brick and mortar companies do have an inequitable situation. We want to try to find the best way to address that. The challenge, of course, is finding a way to do it that does not create more inequity and more complexity than it solves. And that is always the challenge.

And let me, if I could, start with Mr. Cox. You know, there are a lot of smart guys around and a lot of nice guys around here, but

it does not happen so often that they come in the same package. In your case, Chris, it did, and we appreciate you being here.

And I know that others have already described this, but as you know, some suggested that there is a software that can help businesses facilitate tax collection on remote purchases. Can you clarify to the Committee if you think the improved technology fully alleviates the collection burden, especially for these small businesses?

Mr. COX. Well, it is an important question because one might think there is an app for that and that we can then assume the problem away. But, in fact, in addition to the integration costs, which we discussed earlier, that are substantial even for businesses of, you know, say $5 million, we are talking about tens of thousands of dollars of integration costs that are not accounted for in the "free software."

But more important than that, because this analysis is really all about burden, the liability for getting it wrong always is going to rest with the taxpayer because if you write in the legislation that for software errors the software company is responsible, well, what will happen in real life? What will happen is that when a mistake is made, the software vendor is going to say it was not my fault, and then what do you do?

Then you get a right to litigate, and that is enormously expensive. There is not time, there are not resources in the Federal system usually to contend with the long wait to trial before a judge, where you put facts to the law. And that is why over 90 percent of cases in the Federal system settle. So you are not really giving people what they need, which is the comfort that it is not their responsibility.

And as I mentioned earlier, sometimes these laws, not the rates, but the laws about, you know, what is and what is not taxable are exceptionally densely reticulated. They are very complicated. And the software might or might not get it right. But as I say, if the software does not satisfy the tax collector, then you will certainly hear about it as the taxpayers.

Mr. FRANKS. Mr. Chairman, it is my opinion that if we do have some kind of a mechanism, as you suggested, that States compete, that it not only incents productivity and serves the buyer and the seller the best, but that it de-complicates the situation. So I guess my next question is for Mr. Crosby. How would the MFA need to be amended or other remote seller legislation be written to make the collection process so simple and expensive as to render a small business exemption unnecessary, as suggested by Chairman Goodlatte in his principles? Is there a way to do that?

Mr. CROSBY. Certainly, Mr. Franks. Thank you for the question. Your home State of Arizona is a good example of a State that has worked diligently over the past few years to simplify their own sales taxes for sellers that are already collecting the tax. The Marketplace Fairness Act included a number of simplifications. In my testimony I lay out several more that could be considered by this Committee to make it simpler for remote sellers.

To your previous question about software, software certainly cannot do everything, but it can do a lot, especially if it is combined with a rational framework that this Committee and this Congress could set, such as providing for audit protection for remote sellers;

for those who are larger to provide a consolidated audit so they would be only audited one time; a single point of collection or a single point of remittance so that they only remit to one place; a single point of registration. All the sorts of things that relatively easily done and that are part of the Streamline Sales and Use Tax Agreement right now could be extended to sellers across the country to minimize the risk that Mr. Cox identified of litigation.

As Mr. Kranz has noted, without congressional action, that litigation is likely to be much more diverse and much more burdensome on businesses as States are increasingly looking to make sure that the taxes that are legally owed are collected.

Mr. FRANKS. Well, thank you, Mr. Chairman. I guess I am pretty much out of time here, but it just goes to show you that if you just do it like Arizona does it, most of these problems would go away. [Laughter.]

And I appreciate you all coming.

Mr. GOODLATTE. I am glad to hear that. And the Chair now recognizes the gentleman from Florida, Mr. Deutch, for 5 minutes.

Mr. DEUTCH. Thanks, Mr. Chairman. And, Mr. Chairman, I am pleased the Committee is holding a hearing on the pressing matter of remote sales taxes. As a former State senator, I dealt with the issue extensively in Florida, and I understand how crucial the loss of revenue for States and local governments. Twenty-three billion dollars in State sales were uncollected in 2012. We can imagine the impact that those dollars would have in meeting the needs of State and local governments, an important point, I think, for all of us to consider as we are having this important discussion about taxes and about tax law.

First, before I go any further, I would like to request, Mr. Chairman, a letter from the International Council of Shopping Centers** be submitted for the record. Mr. Chairman, if we could ask that this be submitted for the record.

Mr. GOODLATTE. Without objection, it will be made a part of the record.

Mr. DEUTCH. I appreciate it. I think the letter highlights the importance of returning parity between internet and brick and mortar sales, the urgent need for action, and, most importantly, the desire to find a workable solution, which is really what this hearing is about, without getting bogged down in unnecessary partisanship.

And, Mr. Cox, I would just like to take a step back from, again, what is an important discussion with tax law and focus on some of the bigger issues for a minute. You said a minute ago that the analysis is really all about the burden, and I completely agree. And I guess I would ask you and I would ask the panelists, when we think about the burden that we are imposing, should we not also be thinking about the burden that we are imposing currently on business owners in very corner of this country by allowing a system to continue where independent retailers, retailers who play crucial roles in our communities, find themselves at a disadvantage.

I will not ask any of the panelists to raise their hands and tell me if they have ever gone onto their iPhone in a store to check prices, or whether you have then taken the next step of purchasing

**Material previously submitted, see page 8.

something online because it is less expensive and you can avoid sales tax. I will not do that. But I would suggest it is happening a lot.

And when we talk about the burdens that are imposed, the burdens that are imposed are not just imposed on large retailers. And by the way, they are not just imposed on mom and pops. The burdens that are imposed are imposed on entire communities. And when this situation is allowed to continue and stores close, when those stores close, it is not just because the burden on the store owner was too much. The burden then winds up being shared, a concern of yours, Mr. Cox, in this other context. But it is a burden that winds up being shared, and it is a burden that winds up being shared not just by the owner, but by those employees who are out of work.

And when that store, when that retailer closed because they could no longer compete, it is a burden that is imposed on that community. If that store is in a shopping center, we know that if one store closes, others may close as well. And when large portions of a shopping center go dark, that impacts the community. Fewer people come. It makes it more unsafe. It means that more resources at the local level have to be expended in keeping that area safe.

When that burden is imposed on those stores that close, it is, again, not just those stores, but if those stores are downtown, it means fewer people are coming into town. It winds up changing the way that people behave in those communities, and ultimately winds up changing demographics. It can wind up changing demographics of the community, all because of decisions that are made stemming from a tax system that treats different businesses differently.

So I am concerned about protecting small sellers from an overly burdensome tax regime. I am concerned about that. I am also concerned about protecting small sellers from a tax regime that treats them differently. And what I worry about is different tax policies, one, and from some of what we have heard here today, one for traditional retailers that have no online presence, one from brick and click retailers, another one for purely online retailers.

I do not, and I am confident saying that my colleagues here do not believe the government should be in the business of picking winners and losers. That is not something that we should do. And do you not believe, and, Mr. Kranz, I guess I will ask you the question. This current system that we have that places the sales tax compliance burdens on consumers, I mean, ultimately the first question is whether that is fair to consumers, asking consumers to figure out the sales tax for their location and where to send it, to calculate the amount, to send it into the appropriate authority. It is not fair to consumers, is it?

And ultimately, if it is not fair to consumers and it is not fair to the business owners, and we are looking at all of these possibilities that may wind up favoring one business over another, should we not actually move forward with legislation that does what the Marketplace Fairness Act does, which is create a system that is fair to consumers and fair for all business?

Mr. GOODLATTE. The time of the gentleman has expired. We will allow the gentleman to answer the question.

Mr. KRANZ. I think you are exactly right. And what the rules are for that system, what the framework looks like, it is Congress' job to decide. You have the ability to say how much simplification, how much uniformity, what kind of technology should be deployed. The job should be easy enough that it can be done without unduly burdening remote sellers in any commerce world. And it should not be done by placing the burden on consumers.

I have a couple of tax lawyer friends who actually track all their purchases and calculate their use tax liability. I do not. I file every year, but I just put a round number on the return because I am not going to take the time to do that. It is an unreasonable burden to put on consumers.

Mr. GOODLATTE. The Chair recognizes the gentleman from Texas, Mr. Poe, for 5 minutes.

Mr. POE. Thank you, Mr. Chairman. Thank all of you all for being here today. Appreciate the testimony. The way I look at this situation being from Texas is the fact that Texas should be able to tax people who do business in the State of Texas. So it is a States' rights issue as far as I am concerned on this issue, and the Federal Government is getting in the way of that.

We do not have a personal income tax in Texas or a business income tax, and I think that is the primary reason why we are doing real well, which is a different issue completely. But our source of revenue to the State is primarily the sales tax concept and property taxes. And I would like to just be clear on the issue as it is today. The fact whether or not under current law a company is doing business out of the State, selling a product in the State, consumer buys product, is there a tax that is owed already under current law, but just not collected?

Mr. SUTTON. Yes, Mr. Poe, that is correct.

Mr. POE. So I get an amen from all six of you on that one?

Voice. Yes, absolutely.

Mr. POE. Okay. To those people who say that it is a new tax—oh, this is a new tax—if we allow States to collect a tax that is already owed, it is not a new tax unless I am missing something. It is a tax that the consumer, the buyer now is supposed to pay, but because there is not enough red tape to make it work, it is not collected by the State. I mean, I guess I am saying the same thing I already said. Is that kind of the same——

Mr. MOYLAN. Mr. Poe, if I may respond.

Mr. POE. You can make it clearer.

Mr. MOYLAN. It is a new administrative burden, and Texas is an interesting example. So the solution that I put forth, origin sourcing, is something that is already employed in Texas for intrastate sales today. And in terms of——

Mr. POE. But it is a tax authority owed.

Mr. MOYLAN. Yes.

Mr. POE. I mean, there is a cost to set the thing up.

Mr. MOYLAN. And I think that the issue with the Marketplace Fairness Act and proposals similar to it is that if you are supporting that, what you are supporting is Ms. Chu's friends from the California Board of Equalization coming to your businesses in

Texas and requiring collection and remittance of their sales tax. And that is a very serious concern from my perspective. It is an interstate commerce concern. It is a burden on those businesses.

And so, I do not think there is a question about whether or not the taxes are collected. It is clear that the use tax system has failed. The question is whether or not something like the Marketplace Fairness Act or the proposal that I forward or what have you is a way to address that without violating those principles of States' rights being important, but ending at the State border. And that is something that I suspect you probably agree with generally. And I would put forth to you that the Marketplace Fairness Act fails that test.

Mr. CROSBY. Mr. Poe, if you would not mind if I respond. What Mr. Moylan's proposal would try to do is have Texas residents pay tax to another State, and that is clearly taxation without representation. The money would go to the other State. The other State would use it.

People who move to Texas, as you say, many of them move because there is no personal income tax. They know when they live there, their sales tax funds government. If they make a choice to purchase online under an origin sourcing system to avoid that tax, that is not tax competition. That is tax arbitrage, and it is something that the Congress certainly should not endorse.

Mr. POE. Mr. Cox, did you want to say something on that?

Mr. COX. Yes. It just occurred to me that Mr. Crosby probably does not live in the District of Columbia.

Mr. CROSBY. I live in the State of Maine.

Mr. COX. Right. So when he buys lunch here and pays sales tax to the District of Columbia, is that something that is——

Mr. CROSBY. I think that is perfectly fair. I am here using the services. I am physically present here. It is a destination basis. Destination basis does not mean where I live. It means where I purchase the good, where I take possession of the good, where I consume the good.

Mr. COX. So I am happy to hear that you are in support of the District of Columbia collecting tax on you even though you live in Maine and you are the customer.

Mr. POE. Just a second. Wait a minute. I am reclaiming my time. [Laughter.]

This is not a debate format. I am in charge for another minute and a half anyway, but I appreciate it. Mr. Cox, let me specifically ask you really the same issue. Is your concern the way this problem is solved, or do you think that this is a new tax completely, and we are just raising taxes on folks?

Mr. COX. It is absolutely a question of how to solve this problem. You know, the art of taxation is like plucking a goose. The object is to get the most amount of feathers with the least amount of squawking. And the squawking is related to——

Mr. POE. Would you say that one more time? [Laughter.]

Mr. COX. The squawking is related in large measure to the burden, the compliance burden, because, you know, if your object is to collect the tax, if you could do it in an absolutely frictionless way, that would be ideal. If you did not want any squawking, you would

collect no taxes, but, of course, that is off the table because we are trying to raise revenue. That is the object.

So the next best thing is minimize that compliance burden. And the trouble with MFA and the trouble with any system that sets 46 different taxing jurisdictions against one business or 9,600 taxing jurisdictions against one business or a business with locations in 4 or 5 States, what have you, is that there is innately a compliance burden.

And it has been very, very carefully laid out here this morning with the State of Florida as an example, you know, just in one State, complying with these laws is very, very difficult. And nothing that Congress can do, no matter how you write the law, is going to take away the ultimate liability that the business bears. And it is particularly burdensome for a small business.

Mr. GOODLATTE. The time of the gentleman——

Mr. COX. One other thing about the compliance burden that I want to say——

Mr. GOODLATTE. We are very short of time. I just want to——

Mr. POE. I yield back.

Mr. GOODLATTE [continuing]. Remind all Members that we have votes. We are now told they could occur as early as 1. And if that occurs, some of our Members are going to get short-changed.

Mr. COX. Mr. Chairman, I just wanted to add that nobody has mentioned: catalogs. There is no app for that. The compliance for catalogs is you manually do it, and that is really hard.

Mr. GOODLATTE. Got it. The Chair recognizes the gentlewoman from Texas for 5 minutes.

Ms. JACKSON LEE. Mr. Chairman, thank you so very much. It is good to see you, Congressman Cox. Thank you all for your testimony. Just for the record, I was the Ranking Member on the Homeland Security Committee, and so I was delayed. I thank the Chairman very much and my Members.

In a hearing some while back, Representative John Otto of the Texas State House of Representatives in a question that I asked regarding—the hearing was on a different topic—regarding the fairness and exemptions for online small businesses, not for the bricks and mortar. But the point that he made, I think, is relevant for this particular hearing. And he made the point that out of the State of Texas, that an estimated $600 to $800 per year in sales and use taxes goes uncollected from out-of-State sales. With that premise, I want to raise my questions.

I also want to put on the record that unfortunately many of our State elected officials think that it is attractive to continue to reduce corporate property, personal income taxes. Certainly we are sympathetic to those who pay it, but at the same time, the education of our children goes lacking. The need for water reform and for issues dealing with the environment, issues dealing with healthcare, State healthcare in particular, the bricks and mortar that they need to have goes lacking.

So this is not an attempt to punish any industry as much as it is to recognize there is some relevance, very strong relevance, to fairness. And certainly I want to put on the record that I believe that the investment that is made in bricks in mortar in particular, even though there are also small proprietorships that may be

worked from their home. But the input that they have on the infrastructure is crucial to be able to be responsive, too.

Now, we are looking at what kind of construct can we have. So I want to ask Mr. Moylan, can you explain the—and this is in the backdrop of the Senate-passed bill that is now looming large in front of us. Can you explain the origin sourcing and its potential effects on State revenue?

Mr. MOYLAN. Sure. Origin sourcing is, as I mentioned earlier, already in effect in your home State of Texas for intrastate remote sales. So if somebody from Austin purchases something from Houston, the business in Houston would collect that tax and remit it to the appropriate authority.

And so, what I am suggesting is that Federal Government take the standard that already covers some, you know, 92 to 94 percent of all commerce today—business to consumer, retail commerce—and extend it to that last 6 to 8 percent, which exists online for remote sales—online and catalog, as Mr. Cox pointed out. And so, I think that that is a much simpler solution. It is certainly dramatically simpler in terms of collection for the business.

And what it is based in is the notion that the taxpayer for purposes of sales tax is the business rather than the individual. Certainly it is a complicated issue that, you know, there is no sort of obvious answer to any of these things. But in terms of who has the legal burden of complying with that tax in terms of who would face audit and enforcement action, it is the business. And in that case, I think it is reasonable to have the business collector remit that tax based on where they are selling from. And that is the idea behind origin sourcing.

Ms. JACKSON LEE. It certainly is a very fair system to the extent that it is logical. The question would be whether or not we have a landscape in America where nobody in some jurisdictions are selling anything. What you are suggesting is if Houston sells it, wherever it goes, Houston collects it, and Houston gives it to the State or to the local jurisdiction. But do we have the potential of some areas where, you know, where there is not that kind of commerce going back and forth? Do you see any inequities there?

Mr. MOYLAN. Yes. If I take your question correctly, what you are referring to is this concern that there would sort of a race the bottom, that people would move to States like New Hampshire or Montana that do not have sales tax in order to avoid collection. And what I stated in my written testimony is that Congress can and should make sure that any Federal rule restricts a business' ability to do that so that we do not have them gaming the system. I think that is an important——

Ms. JACKSON LEE. Mr. Kranz, I am coming to you, but let me pose a question, and then you can expand. Can you touch on the problem as you see with the origin sourcing approach, and then maybe you want to expand on that question?

Mr. KRANZ. Well, I will tie it back to the question you asked earlier, which is what is the impact on State revenue. So in Texas, you have an origin system for intrastate sales, inside the State from one county to another. What Mr. Moylan and Mr. Cox are suggesting is that we use an origin system between States in interstate commerce.

Well, it would be very easy for me to consult with Texas businesses and say, here is how you can avoid collecting Texas tax at all. And while I respect that they think there are ways to prohibit it, great tax lawyers other than myself will help companies figure out how to game an origin system very easily. It is why no country in the world has adopted one. So the impact on Texas revenue——

Ms. JACKSON LEE. And what would you offer then?

Mr. KRANZ. What would I offer? I think the origin sourcing is dead on arrival, and cannot be considered as an alternative. So whatever the framework is that Congress adopts if it adopts any framework, it has to have a destination regime. All 45 States that have a sales tax use destination sourcing today. It is only in intrastate sales where we see origin sourcing. And if you took it out of the intrastate environment and forced it on the States in an interstate environment, you would have dramatic revenue impacts.

Ms. JACKSON LEE. And you believe no State would be left out?

Mr. GOODLATTE. The time of the gentlewoman has expired.

Ms. JACKSON LEE. I thank the gentleman. I will look forward to adding any questions. Thank you, Mr. Chairman.

Mr. GOODLATTE. The Chair recognizes the gentleman from Utah, Mr. Chaffetz, who has been exceedingly patient, for 5 minutes.

Mr. CHAFFETZ. Thank you, Mr. Chairman. And thank you for tackling a tough issue, but something that the States are clearly scrambling for and wishing to have. I would draw attention, for instance, in my own State of Utah, the joint resolution. We are a fairly conservative State in Utah. Overwhelmingly passed a resolution saying that we have to deal with this, and allow the State of Utah to do what the State of Utah wants to do. That is why I think this bill, the MFA, was not referred to the Ways and Means Committee. It was referred to the Judiciary Committee because it is an issue that we should be dealing with in States' rights. And I think that is right.

I also want to thank Congressman Womack, who I think got us off on the right foot in moving in the right direction. I do see that there are a number of things that I think the e-tailers, if you will, have pointed out that need to be addressed, that can be addressed, to make it a better bill. As you know, I am working to try to get the disparate groups together to try to tackle the audit provisions, the integration costs, the compliance burdens, particularly that a small upstart that would have to deal with. How do we phase this in?

But I think if the Congress will—and we will—tackle those issues, we can create what I think is the right principle here, and that is one of parity. I think every one of you have said that parity is an important principle and an issue.

Mr. Moylan, would you disagree that parity is an important issue?

Mr. MOYLAN. It is very clearly an important issue, and that is why I put forward an origin sourcing solution that I think does that.

Mr. CHAFFETZ. Okay. Hold on. If you agree with parity, I do not see how you can ever get to parity under an origin-based system ever because if you are in Oregon and you have no sales tax bur-

den, and you buy something from, say, the State of New York, you are going to have to pay that sales tax, correct?

Mr. MOYLAN. That is correct, yes.

Mr. CHAFFETZ. Okay. So if you are standing there in Oregon buying the exact same thing, and you are paying zero sales tax by buying it there locally, but if you go over to the internet and buy it out of New York, suddenly you have got to pay a double digit percentage sales tax, correct? That is not parity.

Mr. MOYLAN. Well, I would respond by saying this, that what you are pointing to gets back to the original point that I made about who the taxpayer is for the purposes of sales taxes. It sounds like you are saying that the individual is what you are looking at. What I am suggesting is that because the business has the legal and administrative burden of the tax——

Mr. CHAFFETZ. Hold on. Hold on. Let us tackle that issue right there. When I go to buy something, I get a receipt, whether it is online or I am there in person. And it is going to have a couple of line items: cost of the good, the sales tax, and the shipping if there is shipping. I pay that. It is not the company that pays that.

What I am trying to say, and I think you make a good point in one regard, if we can diminish the integration, the audit, the compliance, and the integration costs, and smooth those lines so that whether it is the mom and pop who is trying to do this out of New Hampshire or Virginia or Utah, wherever it might be, so the big, big company that does may not have physical presence in every State. If we can soften that burden, then I think we are onto something, and we can get to actual parity.

But the problem I have with origin-based is that you never, ever get to parity. You just do not.

Mr. MOYLAN. I think what we are getting at is the difference between the legal incidence of a tax and the economic incidence of the tax. And what you are referring to, the economic incidence, who bears the financial costs, so to speak, absolutely it falls on individuals, just as every tax under the sun does. The corporate income tax, as we well know, falls either on workers, on shareholders, or on customers.

Mr. CHAFFETZ. We are on a different tax. We are talking about sales tax. When I go and I purchase an item, there is a line item for sales tax. And what I am saying is, if they are going to truly have parity, that person in Oregon who chooses to live there, and maybe they are taxed a different way like in Texas. But if they are choosing to live in a State that has no sales tax, I think they should have that parity. Let me go on.

Mr. MOYLAN. May I respond quickly on the parity concern?

Mr. CHAFFETZ. I would just as soon put a knife in the middle of the room and let you all scramble and fight for it, and I think that would be much more interesting. But maybe Mr. Kranz can tackle this one in the comments that we are talking about here.

Mr. KRANZ. Yes. I think Mr. Moylan would be happiest if we went to a VAT, if we adopted a system of tax that truly and unequivocally taxed production. That is different than what we do in the U.S. today and at the State and local level. We tax consumption. We know where consumption occurs. Mr. Crosby gets his lunch here in D.C. He is consuming the lunch in D.C. He should

pay tax here because that is where the consumption occurred. That is how we tax today.

Mr. Moylan and Mr. Cox's proposal would upend that and would impose tax on production, which I think most of us would agree is not now we want to grow our economy.

Mr. CHAFFETZ. And I do agree. I think taxing based on consumption as opposed to production is something that we ought to be deeply concerned about.

I have purchased things here in Washington, D.C., and I have said, you know what? I am a resident in Utah. I should not have to pay that. I have them actually ship it to Utah, the exact same good I could buy in Utah, and avoid the sales tax. I do not think that is right. That does not meet the principle and the standard that I think we are all trying to get to, which is one of parity.

I do hope, Mr. Chairman, we can bring the disparate groups together. I do think we can tackle these things as I have highlighted here. We have to deal with this. Everybody here is trying to do that. I appreciate that. The States are clamoring for it, and I do hope, Mr. Chairman, that we deal with this sooner rather than later, and appreciate this hearing. Yield back.

Mr. GOODLATTE. The Chair thanks the gentleman, and recognizes the gentleman from Tennessee, Mr. Cohen, for 5 minutes.

Mr. COHEN. Thank you, Mr. Chairman. I thank you for having this hearing, and I have read your principles, and I agree with most of them, in particular the tax relief idea. It is similar to the idea that I have had on a prohibition on discriminatory tax on rental cars and automobiles, not having new or discriminatory taxes in a certain area. And we should make sure we do not have discriminatory taxes where we tax people in ways that are not really fair to them.

This hearing is important, and we need to take up the issue of online sales tax. The State of Tennessee does not have an income tax, at least on earned income, and is reliant on the sales tax for services. At one point, other than Mayor Cicilline, everybody here was from a State—Texas, Florida, who may have just evaded or avoided us now, and Washington State and Tennessee—that are non-income tax States. No surprise, I guess, that we are here.

We are losing millions of dollars in revenue that the State needs to provide services, which they can. So the average citizens are being heard as well as mainline businesses, which have to compete with this new technology and a way to buy products that takes away from their opportunity compete in commerce. This is, of course, not a new tax. It is just simply collecting taxes that are already owed, and they are paid by our hometown retail folks, brick and mortar stores, that have a competitive disadvantage.

I have been a strong supporter of this for many years. I was on the Executive Committee of the National Conference of State Legislatures for 6 years, and I enjoyed my service as a State senator from some of the 24 years that I was in the State senate. But I enjoyed all 6 years of being on the NCSL Executive Committee, and that was one of the major issues the NCSL had for that time, which goes back over a dozen years, give or take now.

A former colleague of mine, Republican State Senator Bill Clabough, was a leader working on this issue. And the governor of

our State, Republican Bill Haslam, has been an outspoken advocate for the Marketplace Fairness Act, which would allow the collection of online sales tax to help our State.

I am a proud sponsor of this bill, and it passed the Senate in a bipartisan fashion last year. And I would have thought the next logical would be to bring it for a markup, but I understand that we have to go through the process. And I hope that Chairman Goodlatte will see the process does go through, and we can pass this bill. There are concerns, of course, on how it might affect small business, but I think we can work those out.

Today we have got some new proposals, and I do not know if it was Jason or whoever it was who wanted to see a knife fight out here. Well, I am not for a knife fight. I am against dog fights, and animal fights, and cock fights, and knife fights. But I hope we can work out these five different principles in a more conciliatory fashion, and come together with a bipartisan solution and legislation on this problem.

As we are discussing this issue of taxes on remote sales today, Mr. Chairman, we also need, I think, to examine the issue of sales tax on digital goods, like downloaded music or apps. There are significant changes about which jurisdiction has the right or questions about which jurisdiction has the right to tax digital goods, which can lead to substantial confusion and multiple or discriminatory taxes, which we both oppose.

The former Chairman of this Committee, my good friend, Mr. Lamar Smith, has a bill which I support called the Digital Goods Tax Fairness Act. We have a youthful Chairman this year, but I hope he can remember his senior predecessor and give some allowance and remembrance and give him a little, I guess, feedback and allow that bill to come up for a vote, and give us a uniform national framework on that issue, too.

Understanding votes are coming and lunch is in the offing, I give back the remainder of my time.

Mr. GOODLATTE. The Chair appreciates the gentleman, and recognizes the gentleman from Pennsylvania, Mr. Marino, for 5 minutes.

Mr. MARINO. Thank you, Chairman. Good afternoon, gentlemen. Thank you for being here. First of all, let me clearly state I am a States' rights guy. I think the less Federal Government in my life, in our lives, the better off we are. But with that said, I am extremely concerned about the uneven playing field that currently exists between brick and mortar stores and online retailers.

However, I think it is critically important that any legislative solution to this disparity be very narrowly focused. As we all know, Congress has a history of trying to fix a problem, and in the process creates a dozen new ones. This is a new tax to those from whom the tax has never been collected. It is a new tax on them if it has never been collected. And I am one to not support an increase in taxes.

So with that said, Mr. Kranz, could you please give me a brief sundry list of the complications involved in enforcing the internet tax, because there is always a complication involved.

Mr. KRANZ. Well, you know, tax lawyers need to do something and so do tax accountants. Fortunately, the world has changed, and

we now have software. I do not sit down with paper forms and do my income tax return anymore. There is software to do that. People do not sit down and do sales tax returns on paper anymore. There is software to do that.

So the burden has shifted, and I think what is being discussed is should it shift more. Should it shift to the States and the software companies, because right now software is out that is available. In the streamline States they are paying for it, and retailers do not have to.

Mr. MARINO. Let me stop you there, if I may. I could not agree with you more. However, many of the small businesses in my district in Pennsylvania are owned and operated by family members, generations, many seniors. And I have seen in numerous situations where—my mother is 82 years old, and she gets on the internet and does her tweeting with people. But I have been on the internet and purchased things here and there.

It is not as simple as just saying there is software out there to take care of these issues because it is not a one-two step. And if you are not use to doing something like that, I think it is going to be quite shocking to the business people and they'll just throw their hands up and say we have got a problem here if we cannot do this. Sir?

Mr. MOSCHELLA. Mr. Marino, I understand that there are over 43,000 zip codes in this country, and if your small businesses are shipping to locations all around the United States, they are integrating the shipping prices from the common carriers for the post office. So, you know, if they are able to collect payment electronically, if they are able to integrate their shipping data electronically, the State taxes can be done electronically as well.

Mr. MOYLAN. Can I respond to the software issue briefly?

Mr. MARINO. Sure, go ahead, please.

Mr. MOYLAN. The problem with software is that it is all dependent on humans at some level.

Mr. MARINO. Sure.

Mr. MOYLAN. And I pointed this out in my written testimony, the example in Wisconsin. In that case, it was about the taxability of ice cream cake and the enormous complexity. There was a 1,400-word memo about the taxability of ice cream case, the number of layers of this versus that, whether it is served with utensils.

Ultimately, this is just one example of how humans have to decide is this item taxable, is this in the base or not. And then you put it into the software, and the software does calculations for you. But software cannot figure out whether or not ice cream cake is taxable——

Mr. MARINO. I do not dispute that it can be done. I just dispute that it can be done as simply as we think it can be.

Mr. MOYLAN. I am agreeing with you wholeheartedly, yes.

Mr. SUTTON. That is absolutely right. The software side of it, if you read the Marketplace Fairness Act, which I am sure everyone here has, you will see there are some beautiful exemptions in there. There are exemptions for the software providers, and there is what appears to be an exemption for the retailers, the remote sellers, but it only exempts them if their software provider made

a mistake. But it is the retailer that keys it in, just like Mr. Moylan said. So they are not exempted from those mistakes.

Mr. CROSBY. And I think the biggest problem is the ice cream cake would be melted by the time it arrived.

Mr. MARINO. Not with me around. In the interest of time, I am going to yield back the balance of my time, Chairman.

Mr. GOODLATTE. The Chair thanks the gentleman, and recognizes the very patient gentlewoman from Washington, Ms. DelBene, for 5 minutes.

Ms. DELBENE. Thank you, Mr. Chairman. First, I would ask unanimous consent to submit two letters for the record supporting remote collection authority legislation, one from the Federation of Tax Administrators and another from the National Governors Association, the National Conference of State Legislatures, the Council of State Governments, the National Association of Counties, the National League of Cities, the United States Conference of Mayors, and the International City-County Management Association.

Mr. GOODLATTE. Without objection, they will be made a part of the record.

[The information referred to follows:]

Statement of the
Federation of Tax Administrators

Submitted to the
Judiciary Committee
of the
U.S. House of Representatives

On the Subject of
Exploring Alternative Solutions on the Internet Sales Tax Issue

March 12, 2014

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Introduction

The Federation of Tax Administrators (FTA) is an association of the tax agencies in the 50 states, the District of Columbia, New York City and the city of Philadelphia.

We very much appreciate the Judiciary Committee's interest in this issue. The most critical tax issue facing states is the enforcement of sales and use taxes. Granting states the authority to require so-called "remote sellers," including Internet sellers, to collect sales taxes will level the playing field for competing businesses, improve compliance with taxes that are already owed and remove artificial restrictions that inhibit business investment.

Background

The need for a solution to the state sales and use tax collection problem results from U.S. Supreme Court rulings under the dormant commerce clause doctrine. The Supreme Court held in *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) that a state may not require a seller that does not have a physical presence in the state to collect sales or use tax on sales into the state. The decision was based in part on the complexity of the sales tax system for so-called remote sellers (nonresident sellers without a physical presence in the state of purchase). While the Court recognized that this rule would effectively exclude an ever-growing segment of the retail economy from sales tax, it also noted that Congress could address the issue through its power under the Commerce Clause.

Since the *Quill* decision, online retailing and remote sales have exploded as the Internet has become the preferred way of doing business for many U.S. individuals and companies. To address the issue of complexity for multistate sellers, states worked closely with the business community for almost a dozen years to

simplify administration of sales and use taxes for traditional fixed-base retailers as well as for remote sellers. A major goal of the Streamlined Sales Tax Project was to reduce the compliance burden for multistate sellers.

The Project created the Streamlined Sales and Use Tax Agreement. The Agreement sets out sales tax simplifications states must adopt in order to be members of the Streamlined Sales Tax Governing Board. The Agreement was created in November 2003 and became effective on October 1, 2005, when the requisite number of states simplified their sales and use taxes in accordance with the requirements of the Agreement. Key simplifications addressed by the Agreement include state-level administration of all local sales taxes, greater use of technology, safe harbors for sellers, and uniform definitions.

Additionally, a number of states participated in the Streamlined Sales Tax Project but, for various reasons, chose not to conform to the Streamlined Sales and Use Tax Agreement. These states have also been very active in the discussion to simplify the process for remote-sellers to accurately report sales and use tax. The issues and concerns raised by the non-Streamlined Agreement states, in part, resulted in the dual qualification methods included in the current Marketplace Fairness Act.

Position of the Federation of Tax Administrators

The FTA has long regarded this issue to be a matter of the highest importance. Legislation passed in the Senate would significantly improve tax compliance for both large and small states, as well as local governments. At the same time, such legislation will create a level playing field for the "brick-and-mortar" businesses and their out-of-state competitors selling to customers in the state.

FTA therefore supports the enactment of federal legislation that would authorize states to require remote sellers to collect sales and use taxes on goods and services sold into the state. A significant number of states have simplified their sales

taxes and it is time for Congress to act on remote sales legislation. Remote sales legislation should be self-activating and not require additional federal authorizations or rulemaking, and it should respect the authority of the states to govern their own laws, regulations and requirements. Federal legislation should not incorporate any language that limits state taxing authority.

The most important elements of a bill that would assure the participation of the greatest number of states under the Act are:

- Authority granted to states that are either:
  - Members of the Streamlined Sales and Use Tax Agreement, or
  - Choose to conform their laws to federal statutory standards;
- 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;
- 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;
- A related recognition of the need for a state to have the flexibility to structure its taxes in a simplified system that reflects the needs of its citizens;
- Preservation of state authority to require sellers to maintain necessary records; and
- Exclusion of any mandatory vendor compensation provision.

The FTA urges the House Judiciary Committee to give serious consideration to legislation that would address the problem of enforcing the sales and use tax, giving states the ability to collect the revenues already due and retailers the ability to compete on a level playing field.

March 12, 2014

The Honorable Bob Goodlatte
Chairman
Committee on the Judiciary
United States House of Representatives
2138 Rayburn House Office Building
Washington, D.C. 20515

The Honorable John Conyers
Ranking Member
Committee on the Judiciary
United States House of Representatives
2138 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Goodlatte and Ranking Member Conyers:

We write on behalf of our nation's state and local governments to express our appreciation for your efforts to develop principles and draft legislation that will finally solve the issue of remote sales tax collection.

As representatives of state and local government, which rely heavily on sales taxes to fund vital programs and services, we agree with your assessment that the remote sales tax issue is not about enacting new taxes, rather, it is an issue about collecting taxes that are already owed. Our nation's main street retailers provide employment to our citizens, contribute to our charities, and help to keep our communities vibrant. It is inherently unfair that they must collect sales taxes while their online competitors do not.

As you are aware, the inability of states to require remote sellers to collect the legally imposed taxes on transactions resulted in an estimated $23 billion loss of revenue for states and local governments in 2012; an amount that continues to increase with the growth of online sales. This erosion of the sales tax base will require state and local governments to take other steps to ensure balanced budgets, potentially placing further pressure on local businesses and slowing our economic recovery.

In 1992, the Supreme Court's *Quill* decision urged Congress to address the issue of sales tax collection by remote sellers. State and local governments responded by working with businesses to craft the Streamlined Sales Tax and Use Agreement, a volunteer system designed to exchange tax simplification for collections. States have also enacted affiliate nexus laws to address the issue. In fact, the recent decision by the Supreme Court to not consider the challenge brought in *New York v. Amazon* has magnified the fact that a national solution is only possible if Congress acts.

Following Senate passage of the Marketplace Fairness Act last year, several states made plans to use their increased collections to reduce sales and income tax rates or to pay for investments in critical services such as highway and infrastructure improvements. These

The "Big 7" is a coalition of seven national associations in Washington, D.C., whose members represent state and local governments. The leadership of these organizations works together regularly to discuss issues of mutual interest affecting state and local governments. Members of the "Big 7" include: The National Governors Association, the National Conference of State Legislatures, The Council of State Governments, the National Association of Counties, the National League of Cities, The U.S. Conference of Mayors and the International City/County Management Association.

commitments, however, are dependent on the enactment of legislation this year.

With Senate passage of the Marketplace Fairness Act and the introduction of your legislative principles, Congress has a clear path to move forward with legislation that will level the playing field for all sellers, increase competition for consumers and strengthen the sales tax base for state and local governments. We stand ready to work with you, your staff, and members of the House Judiciary Committee to advance legislation this Congress that would allow states that enact certain simplifications the authority to require remote sellers to collect and remit sales taxes.

Sincerely,

Dan Crippen
Executive Director
National Governors Association

William T. Pound
Executive Director
National Conference of State Legislatures

David Adkins
Executive Director
The Council of State Governments

Matt Chase
Executive Director
National Association of Counties

Clarence Anthony
Executive Director
National League of Cities

Tom Cochran
CEO and Executive Director
The U.S. Conference of Mayors

Robert J. O'Neill, Jr.
Executive Director
International City/County Management Association

Ms. DELBENE. Thank you. I just want to thank all of you for being here today. This is an incredibly important issue, one that I have also worked on as former director of the Department of Revenue for the State of Washington, which is an original streamline State and has been very engaged in this for a long, long time. And I want to highlight how important it is for small businesses that we address this.

We talk about burden, but if you walk down the street in many towns in my district, for example, there is a running store in Mill Creek, Washington called Run 26. The owner there has talked

about many examples of people coming in, trying on shoes, talking to sales associates there about what they need, and in the end buying something online so they can avoid paying that 9.6 percent sales tax. And that difference is an unfair difference. That 9.6 is the incentive for someone to buy online.

And in many cases, this concept of what people call show rooming is the idea that people are actually looking for help on products to make decisions on products. And they are using local retailers to get information and then buying online. And that disparity is a huge disparity. It is decreasing not only sales tax revenue collections, but it is also hitting our small Main Street businesses. And I hear these stories over and over. And so, it is incredibly important that we address that and make sure we have an equal playing field.

Some of the things that have been talked about are compliance and complications of using software. I can say as a former entrepreneur who actually helped start up an e-commerce company that there is technology out there that many small businesses actually use technology provided by others to do this work today.

But I did want to ask Mr. Crosby, you talked about a consolidated audit agreement in your testimony and in your written statement. And I wanted you to describe in more detail how you think that would work.

Mr. CROSBY. Thank you. One of the problems that has been raised with the Marketplace Fairness Act is a concern that remote sellers would be subject to audit by multiple States. And so, the easiest way to address that is to simply limit the number of States that could audit a remote seller. And one concept is to require the States to enter into an agreement so that a remote seller would only be audited by one State or a delegate of a State, something that might be set up by the States together. And then, for each audit period, which, as you know, is normally 3 years, a remote seller would at most be subject to audit by one State.

The other option in there is simply to eliminate the audit burden completely for smaller remote sellers who use certified software so that the audit liability would fall there.

There have been questions raised on this panel about whether that is possible. Certainly can write those liability provisions to protect remote sellers from unnecessary audit, and I think it is fairly simple to do if this Committee chooses to go in that direction.

Ms. DELBENE. And, Mr. Kranz, how do you feel about that type of idea, consolidation audit agreement?

Mr. KRANZ. I think it is exactly the direction that Congress should be going. You know, there is software that is in existence today. Making sure that it works, making sure that companies can use it, that everybody is held harmless, that the States provide the information on a timely basis so that the software works, and that we all get to the right answer from a tax collection standpoint. Those are things that can and should be ironed out in the Federal legislative process. Some of it is in the Marketplace Fairness Act in the Senate. If you look at earlier versions of the bill from previous sessions of Congress, there were different things in there.

So all of the guarantees to make certain that our State and local sales tax regime works properly in an e-commerce environment can be addressed by Congress.

Ms. DELBENE. And one more question for you. Some folks had brought up earlier this idea of one rate per State, yet that would create a differential between local sales tax and what people did online. So we have a difference right now where people might have sales tax collected if they buy at a local store, but not if they buy online. Would that not also be a problem if there was one rate per State? Would each still have a difference between what people pay locally and what they pay online?

Mr. KRANZ. There would be, and, you know, presumably it would be a smaller tax differential. I do not know if you were here earlier when I was saying that the one rate proposal really does force a tax increase in the lower tax jurisdictions. That to me is the biggest problem with it.

Even it were only applied to remote sales and you narrow the scope of the problem, it is a rate difference. It does have economic impacts, and I do not think it is the right answer for the larger problem we are facing today. The right answer really is making sure that software technology information and a system is in place to deal with the burden.

Ms. DELBENE. I agree. I think we are trying to get to parity where there is an equal playing field.

Mr. GOODLATTE. The time of the gentlewoman has expired.

Ms. DELBENE. Thank you, Mr. Chairman. I yield back.

Mr. GOODLATTE. The Chair recognizes the gentleman from Idaho, Mr. Labrador, for 5 minutes.

Mr. LABRADOR. Thank you, Mr. Chairman. Mr. Crosby, I have heard you say a couple of times, and I am confused by it. You claim that Mr. Moylan's idea is taxation without representation. That analogy just does not make any sense to me. If you choose to go on the internet and you choose to deal with an out-of-State business, you are choosing to do business with that person, just like you do when you walk to a Washington, D.C. sub shop or when you walk to a Virginia tire store. So I am not really understanding your taxation without representation argument.

Mr. CROSBY. Well, Congressman Labrador, let me explain it a little bit further. I think there are sort of two aspects to it. The first is that you are paying tax to a jurisdiction in which you may never set foot, a State in which you may never visit.

Mr. LABRADOR. But you have chosen to do business with that jurisdiction.

Mr. CROSBY. Certainly, but you have no representation there. I think under——

Mr. LABRADOR. But I have no representation in Washington, D.C. I have no representation in Virginia, and I choose to go to those places to do business when I am here in Washington, D.C. And I do not worry about whether I have representation in their city council or anything like that.

Mr. CROSBY. That leads me to the second problem. If you go to this origin sourcing type of system, it is not at all obvious to the purchaser at the time of the transaction what tax rate will be ap-

plied. And that is because the concept of origin sourcing requires you to fix in a specific place where that retailer is.

When someone is looking online, shopping online, they are usually considering a variety of retailers. It will be impossible at that point in time to know which retailer is located where. You may think, for example, that Amazon is located in Washington, and you would be paying a Washington tax rate. But what if, because Amazon has employees across this country, instead the decision is where the good is shipped from? You may not know this, but at the time the transaction occurs, Amazon does not necessarily know where it is going to be shipped from. That is a separate process that occurs after the transaction.

Mr. LABRADOR. But they are going to tell you, right, when you are making the purchase your sales tax is going to be X amount. Before you hit the send button, you are going to know what tax rate you are going to be paying, and you may choose to go to a different jurisdiction that does not charge as high a tax.

Mr. CROSBY. The point I am making is that Amazon itself may not know at the time you complete transaction where it is shipped from. And so, if the basis is shipping, you cannot use that. As Mr. Kranz pointed out, if you do something like incorporation domicile, number of employees, or any other sort of standard, then you create a system whereby sellers can incorporate entities and put employees in them in States that do not have sales taxes, and avoid sales tax collection all together. So I think——

Mr. LABRADOR. And what is wrong with that? I mean, we have a competitive environment. It seems to me that we are all sitting here worried about people actually reducing the taxes at the State level. And I think we should be for reducing taxes at the State level and making business more competitive. I am worried that this is actually going to make business less competitive.

If you listen to what the Chairman said in the beginning is that where the growth is happening right now is on internet sales. Every time that we choose to tax something, we kill it. Every time we choose to tax something less or not tax it, we actually allow it to grow. Why should that not be what we are actually encouraging here in Congress?

Mr. CROSBY. It may be that you and I have a difference of opinion over what tax competition. I think when I choose to come to D.C. and do something here that I am participating in this economy here. When I choose to reside in my home State of Maine, I am subject to the tax laws there. When I choose to invest in the business that I own part of here in Virginia, then I am subject to the tax laws there.

I do not believe by clicking a button online I am fostering tax competition. I simply think that is tax arbitrage. And if you go to an origin sourcing regime, what you are certainly doing is encouraging non-U.S. commerce because you are exempting all foreign companies from collection of any taxes here in the United States.

Mr. LABRADOR. Mr. Cox, what do you think about that?

Mr. COX. Well, you know, our system at present is one in which an enormous amount of retail commerce takes place as you described; that is, you know, people who buy things in other States. One of our constitutional rights is the freedom to travel, and people

travel all over the place. They travel in their cars. They travel on airplanes. You know, in places like this where States are so compact they can walk across State borders. And I have never heard anyone complain about the existing system.

And so, you have to ask yourself, should we upend it? Is it somehow offensive to our American values? You know, I happen to be here in D.C. It is not like I have a choice of buying lunch in Maryland today. I mean, I am going to pay the taxes here whether I like it or not, and I am not represented here. That is not the issue. That is a red herring.

The question is, is it a straightforward tax on my consumption, and the answer is, yes, it is. It gives me the opportunity to put to rest another canard because I think I heard Mr. Kranz earlier suggest that the idea of home rule and revenue return is somehow a tax on production and not on consumption, and that is absolutely false. It is a sales tax. The tax and the economic incidence of the tax is on the consumer. The money goes to the State where the consumer lives. That is a consumption tax period. It is not at all a tax on production.

Mr. LABRADOR. That actually was going to be my follow-up question. And my time has expired, so thank you very much for your time.

Mr. GOODLATTE. The Chair thanks the gentleman, and recognizes the gentleman from Rhode Island, Mr. Cicilline, for 5 minutes.

Mr. CICILLINE. Thank you, Mr. Chairman. I would first ask unanimous consent that the statement of the National Conference of State Legislatures*** issued today in response to this hearing be made part of the record.

Mr. GOODLATTE. I apologize——

Mr. CICILLINE. No. I am not just asking unanimous consent that it——

Mr. GOODLATTE. Without objection, it will be put in the record.

Mr. CICILLINE. Thank you, Mr. Chairman. I thank the witnesses for being here. And I am new to this Committee, but not completely new to this issue. And frankly, as I listen to the testimony and review the materials over the last several days, I am not sure why we are not acting on the Marketplace Fairness Act. It seems as if this has been a very long discussion by this Committee. I served as mayor of a city before I came to Congress, and I have seen in my home State the impact of the loss of revenue because of online sales escaping State sales taxes.

The National Conference of State Legislatures estimates that States have lost $23.3 billion in uncollected tax sales tax from online and catalog purchases in 2002. And my State during that same time period lost $70.4 million and for all the reasons Congressman Deutch spoke about. That has an impact not just on revenues and services in cities and in States, but on services in cities and in States, but on quality of life, on the prosperity of Main Street, on the ability of retailers and small businesses to compete. And it is, frankly, a system that is just not fair to our small business, and retail districts, and commercial districts, which are the heart and

***Material previously submitted, see page 212.

soul of neighborhoods in many instances at a competitive disadvantage.

So I hope we can move on this. I am a proud sponsor of the Marketplace Fairness Act. I want to ask Mr. Kranz, you said many of these proposals were considered and rejected already, so this is not a new discussion. Could you just describe that process for a moment?

Mr. KRANZ. Sure. This discussion has been going on for decades really, and legislation was introduced for the first time in Congress in 1973, more than 40 years ago, to deal with it. So throughout the last 40-plus years, there have been discussions about origin sourcing. There have been discussions about reporting regimes.

All of these ideas are not new. And much of the discussion that has taken place was a collaborative effort between businesses, both Main Street business and dot.com, and State government representatives, both governors, legislatures, cities, counties. They were all at the table trying to come up with a solution to this problem. The solution that they have gotten behind has been the Streamline Sales and Use Tax Agreement and the Senate Marketplace Fairness Act and earlier versions of that legislation.

It really represents an effort by the State government community to reach their hand out to Congress not for a handout, but to shake hands and say let us partner, let us solve this problem with a Federal and State solution that fairly deals with remote commerce.

Mr. CICILLINE. And I hope we can get to that point because I know it is very important for my State, and I know it is very important for many communities.

And I just want to ask, Mr. Moylan, because it seems as if there had been some discussions as to whether or not this is a new tax or enforcing an old tax. It clearly it is about enforcing existing responsibilities in terms of sales tax. I think the only place that it is actually a new tax is the origin sourcing system because you have those five States that currently pay no sales tax, and under your proposal, they would then become taxpayers of sales tax for the first time. So those are actually new taxes.

Mr. MOYLAN. I would say quite the contrary. What something like the Marketplace Fairness Act would do is require businesses in States like New Hampshire and Montana that have chosen to locate in non-sales tax States to collect and remit sales taxes to every other State that does have a sales tax. So it takes away from them a choice that they have made.

And again, this gets back to the issue of who is the taxpayer for this, and my response to it is that the legal and administrative burden falls on the business——

Mr. CICILLINE. Well, that is your description of who the taxpayer is, but the person who is actually paying the tax is going to be the individual purchaser, correct?

Mr. SUTTON. I will tell you——

Mr. CICILLINE. I would like to ask Mr. Moylan that question.

Mr. MOYLAN. We have gotten to this discussion somewhat before, the difference between the legal incidence of a tax and the economic incidence. And I would stipulate that, yes, the economic incidence of every tax under the sun falls on individuals. In this case, the legal incidence of the tax falls on the business, and so for me,

I think that is the right frame of reference. And in that case, that is why I support origin sourcing.

Mr. CICILLINE. Mr. Kranz, it looks like you want to respond to that.

Mr. KRANZ. That is just a misrepresentation of the law across the country. In a majority of States, the legal incidence is imposed on the consumer, and where it is imposed on the business, they are required to pass it through to the consumer. So it is a mischaracterization of what is out there legally. And it ignores the reality of the economics, which is only the consumer is is responsible for the tax burden.

Mr. CICILLINE. Thank you. I thank you, Mr. Chairman. I yield back.

Mr. GOODLATTE. I thank the gentleman. The gentleman recognizes the gentleman from Texas, Mr. Farenthold, for 5 minutes.

Mr. FARENTHOLD. Thank you very much. And I think Mr. Cox hit the nail on the head in answer to a question from Judge Poe. This whole thing is about getting the most down with the least squawking and plucking a goose. And I think legislatures and States see this is an opportunity to say, oh, well, we did not raise taxes. We just started collecting more taxes. But I kind of agree with Mr. Marino who said, you know, this tax was not being collected before and is being collected now. It sure smells like a new tax to those of us who pay it.

And I have sat here. You know, I am familiar with the Marketplace Fairness Act, not a big fan of that. I have heard numerous different proposals here, and it is like we can just punch holes in each one of them. I still have not particularly heard one that I like. I mean, I understand the problem, and we are talking about the administrative burdens of collecting it. And the current system is kind of fair with that respect.

Mr. Moschella, your mall folks, if there is a fire, they are going to call the fire department, and in exchange for the administrative burden of collecting that local sales tax, the fire department is going to respond. The police are going to come out when there is a shoplifter, for crowd control on black Friday. The internet retailers are not getting the advantages of any of those services.

So, I mean, yours kind of falls apart on that one to some degree.

Mr. MOSCHELLA. I do not think so. I mean, as I said before, I want to make two points, one a constitutional one, and then on a practical one. On the practical side, the Congress——

Mr. FARENTHOLD. Quickly because I have got a lot to do.

Mr. MOSCHELLA. Congress did this in 2000. It has worked with regard to alcohol, and it could work under my proposal.

Mr. FARENTHOLD. All right.

Mr. MOSCHELLA. But your question raises an interesting constitutional point of why we are here.

Mr. FARENTHOLD. All right. And I am interested in the Constitution, but I want to get to the nitty gritty on these. We can talk a little bit about the Constitution. Mr. Moylan, I think in the answer to some of your questions you said you should prohibit a business from relocating to a tax jurisdiction or a lower tax jurisdiction. I mean, what about, you know, somebody who is selling something on Etsy in Texas, and their spouse gets transferred to Oregon? I

mean, are you going to shut that business down? I mean, yours falls apart there.

Mr. MOYLAN. No, certainly not. I did not mean to suggest that we should prohibit businesses from moving. What I meant to suggest is that we should prohibit businesses from setting up fake operations in States like New Hampshire to avoid collection.

Mr. FARENTHOLD. And we have all pretty much agreed we cannot tax on a foreign jurisdiction. I ordered a computer for my wife for Christmas. I bought her what I wanted, I confess. But it shipped from Juarez, Mexico. What is to stop a retailer from setting up just across the border shipping in? We have got some great border crossings in Texas, does not cost a whole lot more to ship. You completely avoid taxes that way. I mean, you could fall apart that way just on the international end.

And, Mr. Crosby, you talked a lot about building this database with all these——

Mr. CROSBY. No, not me. I am not a fan of——

Mr. FARENTHOLD. Mr. Sutton, I am sorry. Mr. Sutton, of these databases with all these safe harbor provisions in them. To me, that is a massive creation of Federal regulation. And then if we have the government build that reporting database, we see how good the government is with databases with healthcare.gov. I mean, we cannot compute our way out of a paper bag here in Washington. Go ahead.

Mr. SUTTON. I do not disagree that there is definitely complications, and I got invited to this hearing about 10 days ago and put that together in the last 10 days.

Mr. FARENTHOLD. And I appreciate that.

Mr. SUTTON. So I understand it has been done before. But I have been very much an opponent against the Marketplace Fairness Act for a long time, and something big picture wise. I do not think anybody in here has grasped, because I have heard a bunch of people talk about this is not a new tax. Well, if a business is selling remotely to Florida right now, the business does not have physical presence, it is not subject to sales tax, and it is not subject to use tax because both of those taxes are based on things that happened in Florida.

If this law passes, all of a sudden that business is going to be subject to the sales tax in Florida. So it is going to have an incident of tax where it did not have before. And if it does not pass it onto the consumer, it is liable for it. If it makes a mistake in calculation, it is liable.

Mr. FARENTHOLD. And I understand that. Again, I also remain concerned about the database of stuff going and what is going to be taxed. I mean, in Texas, potato chips are not taxable if you buy them at a grocery store, but are taxable if you buy them in a vending machine. Is the internet more like a vending machine or is it more like a grocery store?

Mr. SUTTON. The complications on the software side are unbelievable, and it is in the Marketplace Fairness Act, and it is in my idea. It is on both sides. But I have talked to two different software providers, one of them who is in this room right now and a huge proponent of the Marketplace Fairness Act, who says their data-

bases, their software, already sanitizes private information out of when it comes out of the vendor. They already do it.

Mr. GOODLATTE. The time of the gentleman has expired.

Mr. FARENTHOLD. I see I am expired, and I appreciate it. And we did not even get into the privacy concerns——

Mr. GOODLATTE. The time of the gentleman has expired, and the Chair recognizes the gentleman from Georgia, Mr. Collins, for 5 minutes.

Mr. COLLINS. Thank you, Mr. Chairman. I think this has been one of the more interesting debates, proposals. It is something that I have heard since I have been up here, and also one of the most interesting things from my district in which I have small business owners and which I have known and loved. I grew up in my hometown, and I have been in my office, and I have almost as many small businesses who did different things come into my office and say we love this, this is the greatest things since sliced bread. They read their talking points and they love it. And then I have had almost as many businesses come in and basically say this is the worst thing in the world, and if you do this, the world will end. Both sides seeming to go to the extremes here.

I think some of the things that I want to go back to, because we have really killed a lot of these issues, origins and different things, on how we look at it. I am thankful that the Chairman is taking this on and presenting principles on what we have to look at because it is an issue that needs to be solved. Our marketplaces are changing, in the way of distribution and in the way of a person is changing.

I think it is also a little hyperbole to talk about companies, and we have named several here today that are closing stores and doing things like that. Some of that could just be because they have a bad sales model, okay? They have never updated. They are not selling like they should, retail. And there is some of that that needs to be taken into account here. It is not all, but it is some.

The other question that I have in this really, and I was talking to my legislative director about this today. What bothers me the most about this issue right now is that we cannot solve it. But my issue is that we are so headlong into solving it, which I believe we need to do because government has got out of picking winners and losers, which we are doing here, is that we are going to close one Pandora's box and open another.

And that is the question that I think I want to talk about. One is the question of jurisdiction. Anybody wants to take this on. But when you deal with jurisdictional issues in the Main Street Fairness Act, you know, is the taxing State's jurisdiction over a remote seller a choice of venue to enforce an action? Where is that going to be a process here? Is there an enforcement action based on the point of sale or the point of consumption? Where would be a jurisdictional question?

Mr. CROSBY. Mr. Collins, in my proposal I address that. It is part of the consolidated audit provision that the remote seller would have choice of venue. So it would enable them to choose the venue so that they could adjudicate any dispute over uncollected sales taxes in their home State or in another State in which they do business.

Mr. SUTTON. Well, that addresses the civil side, but what about the criminal side? They are holding trust funds for those businesses. They are subject to all the criminal laws in Florida. And by creating this law, did you just allow personal jurisdiction over those business owners on the criminal side?

Mr. COLLINS. Well, someone just said earlier concerning, you know, just making it click, I do not believe brings any jurisdiction. I am not sure that is true, Mr. Crosby, especially if you deal in other areas of the criminal code and other areas where if you clock to a site you are not supposed to be on, you have claimed jurisdiction. They can go after you because you have been on the site.

We are going into an area here that I think is, I almost agree completely with the gentleman from Utah. Have all of you here, which I have all been watching and I can see sort of the pattern going, yes, no, yes, no. It is the faces out here. Is just throw it in the middle and say fight it, who comes out on top wins. The problem here is that the bottom line is for all the interest in this room, it is about the consumer. It is about the American populace.

And I understand State and local governments. I served in the State legislature in Georgia in which we took this on, and we passed it. Basically we put the nexus in with the brick and mortars which took out a lot of our "retail internet stores" where they were simply just ordering for folks, avoiding the tax, sitting next door to a place that actually had to charge the tax. We provided the nexus to a building.

And there has been a lot of conversation, well, Georgia did it, so we can apply this to the Nation. The nexus was applied to a brick and mortar. The nexus was not applied to an amorphous, which is something which is already supposed to have been collected anyway. We have all talked about that.

All your proposals are interesting. I think, Mr. Chairman, the question that I have, and maybe just to end it with this. What are the consequences, and I think we probably need to act here. What are the consequences if we do not act?

Mr. KRANZ. It is covered in my testimony at length. But I think the consequences of congressional inaction are that the States will attack remote commerce on their own. Seventeen States have already passed legislation to do that. And there is a discussion in the State tax policy taking place about the States working together as a group to really coerce remote sellers to collect.

Mr. COLLINS. And I agree with you, and I want to get this basically. Another thing that is going on here is if the States and local governments receive this, then there is some kind of tax, you know, that we can offset that. And I know some States will say, well, if we get this, we will offset our own tax rate. I find that very hard to believe. If you get something that you have not been having, why move your bottom line? There is going to be a move to try and do that, but the actual reality there is probably not true.

And with that, Mr. Chairman, I yield.

Mr. CROSBY. Mr. Collins, if you do not mind. A number of States have already done that. In Ohio, it is unfortunate that Mr. Chabot left because he asked this question earlier. In their budget last year, they actually passed a provision that creates a special fund so that any monies that would come in from remote sales are auto-

matically diverted to that, and those monies are then used exclusively for a reduction in the personal income tax rate. Whether that is the right answer for all States I do not know, but it certainly is for Ohio.

Mr. GOODLATTE. The time of the gentleman has expired. The Chair recognizes the gentleman from Missouri, Mr. Smith, for 5 minutes.

Mr. SMITH OF MISSOURI. Thank you, Mr. Chairman. Thank you all for being here, and I am glad to ask a few questions.

Mr. Crosby, my first question is to you. What do you think are some of the difficulties of integrating the sales tax collection software in the existing programs? And also, are there enough providers of software to efficiently handle collecting and remitting to customers in other States?

Mr. CROSBY. Thank you, Mr. Smith. I will take the second question first. Yes, there are enough software providers doing this today, ranging from startup businesses to very large businesses that have been handling payroll in this country for Fortune 500 companies for decades now.

Certainly, if and when the Marketplace Fairness Act or something else like it passes, that market will grow, and there will be more providers that enter into it and that are looking to assist retailers in collecting sales taxes.

To the first question about integration, for the overwhelming majority, probably 99 plus percent of online sellers, the small mom and pops, very few of them hire their own computer consultants to design shopping carts. Almost all of them use off the shelf solutions provided by third parties, whether they are online marketplaces that are out there or third party software providers. To the best of my knowledge, all of the certified sales tax collection software providers that are out there today integrate with hundreds of the most popular shopping carts. So for those businesses, integration is relatively simple. And I have seen demonstrations for a number of different providers where they actually do the integration right in front of you.

For larger businesses, maybe the top 500 online sellers in this country that may have developed their own software to deal with shipping and orders, there may be additional compliance. But in my testimony, I have laid out, I think, that the Committee in the Congress can handle that by providing some allowances for integration costs.

Mr. SMITH OF MISSOURI. Okay. Thank you. Mr. Cox, in your portion of some written testimony, when you were discussing the principles the Chairman released, you have talked about the idea of fairness. Would you mind elaborating on the issue of fairness when discussing the different proposals we have heard today?

Mr. COX. Yes, thank you. And if I might just on integration, in my written testimony there is data from a recent study of integration costs for medium-sized businesses with revenues between $5 and $50 million, and the integration costs range from $80,000 up front to $290,000 up front for these businesses. So it is a real issue.

The fairness question is shot through this whole discussion. There are constitutional issues because we are talking about jurisdiction and the extent of States' power, and some of those constitu-

tional issues are due process issues. And as all the lawyers on this Committee well know, due process at its core is about fundamental fairness. So it is both the political question and it is the technical legal question that we have to resolve.

And we have to ask ourselves at one level is it fair to have a patchwork system in which brick and mortar sales and online sales from somebody right next door are in all senses equal, except one. The answer is no, so here we all are trying to find a solution. Then when you come to solutions, we have to ask ourselves, all right, how are we going to get the administrative burdens and the compliance costs down so it is not unfair in that sense?

And what we have found in the deep dive, not just through the iterations of the Marketplace Fairness Act, but going all the way back to when we first passed the Internet Tax Freedom Act and set up the Advisory Commission on Electronic Commerce, is that while the sales tax itself is part of a competitive differential, the bigger variable in that equation is the compliance costs. And so, we are going to have to make some tradeoffs here. There is no perfect system, as surely this hearing abundantly displays, that neatly solves every problem and makes everybody walk away with a smile.

It is difficult to collect taxes. It is especially difficult with the challenges that catalog sales present, which has not gotten much discussion here because they do not get the advantage of all the computer wizardry that we might bring to bear. But that is the definition, I think, of the fairness problem.

Mr. SMITH OF MISSOURI. Okay. Mr. Cox, would your proposal return the sales tax to the customer State so that it would be used to pay for the benefits, like schools and first responders, that other Members have mentioned?

Mr. COX. Yes. That is a key feature of it. The money is returned to the State of residence of the purchaser.

Mr. SMITH OF MISSOURI. Okay. But to that local jurisdiction.

Mr. COX. Yes. The tax money is treated as would any tax be treated within that State. So if there is a local piece of it, then the local piece would go where it belongs.

Mr. SMITH OF MISSOURI. Okay. Thank you, Mr. Chairman.

Mr. GOODLATTE. Thank you. The Chair recognizes the gentleman from Florida, Mr. DeSantis, for 5 minutes.

Mr. DESANTIS. Thank you, Mr. Chairman. Thank the witnesses. First, I just think some of the arguments that are put forward I may not agree with, but I say they are credible. Some do not strike me as credible. I mean, this idea that States are just going to reduce taxes to account for the increased revenue they get here. I think some States may do that. I mean, I agree probably Scott Walker will try to do that. But ultimately the legislature has got to agree to that. And here you would basically be having Congress imposing a regime that is leading to higher taxes and more revenue for them, so they would be getting the revenue without having to pay the political price of having voted to implement that. And I just think politicians are not going to want free money basically, and so if they have that, they can spend it. So I do not think that is really a good argument for it.

In terms of the representation, I know, Mr. Crosby, you had a colloquy with Raul Labrador. And it seems to me that if I am here in Washington and I pay sales tax for lunch is the example that has been, yes, I am not represented in Washington, but if someone were to mug me, the cops would come. The taxes I am paying actually I am somewhat consuming services by being here.

But, yes, you think that that is, I guess, somehow—I mean, for example, the Marketplace Fairness Act. You do not think that that would be taxation without representation, because it seems to me that if I am a business in Florida and the only thing I do is ship a product to California, if I have no physical presence, I am not stepping foot there, I am not consuming any services. All I am doing is shipping something presumably through U.S. mail or a private carrier. Yet somehow I would be commandeered to be a tax collector for that jurisdiction. So that strikes me as much more in terms of a taxation without representation problem.

And we can sit here and say the regulatory burdens essentially cost these businesses money. So how would you respond to that?

Mr. CROSBY. I think your first point I would agree with in terms of, you know, here in D.C. you are certainly getting the benefits and protections of police, fire, whatever it might be, and so it is not really a question of taxation without representation.

To your second your point of the Florida business who is shipping to a consumer in California where the business has no physical presence, unlike Mr. Moylan, I mean, I agree with Mr. Kranz. The tax burden actually falls on the person in California. So what we are talking about is the regulatory burden or the administrative burden of tax collection.

And having been involved in this for nearly 2 decades now, I am more than convinced that this Committee can craft this legislation that will dramatically reduce, if not eliminate, that burden. I have seen the software work. I know businesses——

Mr. DESANTIS. Do you believe that the Marketplace Fairness Act created a substantial burden for those retailers in that situation, or do you think that that was acceptable?

Mr. CROSBY. So the Marketplace Fairness Act, you know, to your point about sort of State action, would require a State to do something before it would be able to authorize the authority and require remote sellers to collect. In those things that it would be required to do, there are some substantial simplifications in there. Is it enough? Probably not. There are things that this Committee can do that could strengthen it.

So, no, I think certainly there is no burden less than doing nothing. Remote sellers are not collecting now. Anything you do that requires collection is more than what they are doing now because they are currently doing nothing. So there will be some burden. The question is, can you balance the burden on them with the burden on the consumer currently who is required, if they are being diligent about their taxes, to pay their use taxes, and the State and local governments who are currently, because of a Federal preference, unable to collect that revenue?

Mr. DESANTIS. So I take that point, but I do think there is still a lack of a political accountability because if you are being audited by somebody in another State, or even if they do not even get that

far. Even if there are just requests for payments or people are pinging you, ultimately how you are treated by them, you are not going to really have a direct way to affect that.

Now, in terms of the advantage from kind of a remote retail model, Mr. Kranz, how would you respond because it seems to me just looking at what has happened recently, you do have actually a lot of online retailers who have actually expanded their physical presence into additional States. And so, if that is true, then why have we seen that behavior? Would the idea that this is such a boon to be an online retailer not have incentivized them to contract?

Mr. KRANZ. I think what we are seeing throughout the retail world is a recognition that consumers want what is called bricks and clicks. They want retail stores. They want to be able to order online 24/7 when the retail store is not open. So it is not surprising that business models have changed over the last decade, and we went from pure brick Main Street retailers and pure online retailers to a world where often companies have both a physical presence in some States, maybe stores or warehouses, distribution centers, and an online presence that is available to consumers 24/7.

Mr. DESANTIS. So there must have been something about doing that in spite of how the tax would be treated if they were to remain in one jurisdiction that incentivized them to do it. In other words, the tax was not the only issue. There were consumer demands or whatnot, so I appreciate that.

Am I out of time?

Mr. GOODLATTE. Your time has expired.

Mr. DESANTIS. I am out of time, so I will yield back to the Chairman. Thank you.

Mr. GOODLATTE. The Chair recognizes the gentleman from Texas for 5 minutes. I would note that if he is brief, we might get both remaining Members in for a few minutes.

Mr. GOHMERT. Okay. We will try to accommodate that. Appreciate everybody's testimony here today. And there has been a lot of discussion about avoiding penalizing brick and mortar. That is a huge problem I hear about in the district. But instead of getting the Federal Government so much more involved, which is a huge concern of mine. I know some people think, yes, if we just get the Federal Government involved, that will solve our problems. And they learn too late that that is not the solution—hello, Obamacare.

But is there a way to just encourage more collection of current use taxes without getting the Federal Government so involved? Anyone who cares to interject.

Mr. KRANZ. I will jump in here because over the last 15 years there were discussions that said Congress could pass a one-sentence bill that simply overturned the *Quill* decision, and left it to the States to figure it out from there.

Mr. GOHMERT. What do you think of that?

Mr. KRANZ. Well, it is a solution, but it is a fairly dramatic one that does not give remote sellers any protection. It does not guarantee that software will be available. It does not solve the burden question. It leaves that question entirely to the States.

We have seen the States working to solve the burden problem for 15 years in the streamline effort. It is really up to you, though. Do

you want to just turn it over to them entirely? And if you do nothing, I think you are turning it over to the States entirely. They will figure out how to attack this one way or another.

If you think that that is not the right approach to protect sellers, then you need to do a framework. You need to have a framework that is put together by the Federal Government.

Mr. GOHMERT. And, of course, another problem is, and it has been discussed. But if you have an origin tax, I did not hear any solutions, but what is to stop people from moving out of the country where there is no tax, and then they do not have an origin problem? And my friends across the aisle love to talk about penalizing people that move businesses out of the country and then create systems where it completely encourages the very thing they decry.

But one other quick thing. Is there a solution for origin tax that would not drive businesses out of the country?

Mr. MOYLAN. Mr. Gohmert, if I could respond to that. I think that the first thing to point out is that that incentive already exists under current law, that if you are a business that is located overseas, or inside the country to move to New Hampshire or whatever to avoid sales tax collection. Mr. DeSantis pointed out that the experience has actually been that businesses have been expanding their physical presence and building more in the United States precisely because of Mr. Kranz's point that it seems as though the model of the future will be a kind of brick and click hybrid.

And so, there is one point I wanted to make on complexity that I think is important. There is new data out this morning actually from the Tax Foundation that says that the number is not 9,600 tax jurisdictions. It is $9,998, so we are almost at the magic 10,000 mark. And what that says is that all of these suggestions that software can just solve that problem I think are overblown. And I always point to the example of Turbo Tax. If you think that Turbo Tax has solved income tax complexity, then you must think that software can solve sales tax complexity. And personally, I do not think that Turbo Tax has solved income tax complexity.

Mr. GOHMERT. But is that not what our Secretary of the Treasury was using when he could not figure out the——

Mr. MOYLAN. A perfect example of somebody who ought to know better who did not, and there are many of those in the sales tax world as well where you have sometimes honest mistakes. Surely there are fraudulent examples as well. And this is very difficult to——

Mr. GOHMERT. I would ask that anybody that has any further input. I know you guys have been going for a long time, but would welcome any proposals in writing. I know you have provided written testimony, but I would yield back.

Mr. GOODLATTE. The Chair thanks the gentleman for yielding back, and recognizes the gentleman from California for whatever time we can squeeze out.

Mr. ISSA. Thank you, Mr. Chairman. When Henry Hyde chaired this Committee, he often said that even though, you know, somebody goes last, it does not mean they cannot come up with an original question. I am going to try to live up to that Henry Hyde expectation.

Mr. Cox, you and I served together, and a lot of these things do go back to that assumption that we had to not tax the internet for it to prosper. So let me ask a couple of quick questions, and I will accept, unless somebody has an absolute no, that everyone I saying yes. Mr. Cox, is it not true that we are supposed to regulate interstate commerce?

Mr. COX. Yes.

Mr. ISSA. And by definition, interstate sales are interstate commerce. So we have a mandate that we are not living up to by not dealing with this problem, would you not agree?

Mr. COX. Yes.

Mr. ISSA. And is it not true that as a California resident now, or always been a California resident, but back in California if you order something from out-of-State and have it shipped to your home in Orange County, and you do not pay sales tax, you are violating California law. Is that not true?

Mr. COX. That is correct. Our laws are enforced about the same as our immigration laws. [Laughter.]

Mr. ISSA. So I will mention that if my old company were to order something from out-of-State, they get audited every single year by multiple jurisdictions, including California, to see if we bought anything and had it shipped to California. So there is some when it is more feasible.

So just a quick question. Since you would be breaking the law if you do not pay the tax, part of what we are considering is relieving the burden on whatever portion of $318 million who live in the 45 States in which they would be breaking the law if they do not pay tax. In a sense, we are fixing a problem of some large portion, nearly 300 million lawbreakers. Is that not true?

Mr. COX. Yes. Mr. Crosby just mentioned this, you know. Because in theory, and it is mostly theory, everybody in America in a sales tax State owes use tax. When they do not pay the sales tax on out-of-State purchases, we are relieving them of their theoretical sin.

Mr. ISSA. So I am going to ask you a rhetorical question. If we simply made interstate commerce report out-of-State sales to the State in which it was sent to, meaning we send the data on 10 million sales from Florida or Oregon, require they be sent to California's Sacramento, you know, Ouija room, and they had the names, the addresses of all these shipments, in a sense, would we not almost guarantee that the residents of every State would say, please, stop burdening me. Find a solution. I do not want to get this, so I want my vendor to collect this tax because I sure as heck do not want to have to deal with 45 different purchases I made.

I mean, in a sense we are dealing with if the American public were forced to recognize the law that they are not supporting in their own State, we would have an outcry of hundreds of millions of people asking us to fix this, would we not?

Mr. COX. Well, I think it is fair to say that if you take a look at the behavior of the State legislatures and governors, that the last thing they want to do is enforce use taxes on their own citizens. And so, what they would much prefer to do is impose those burdens on people that do not live in their State.

Mr. ISSA. Well, there is no question that the State of California has been very good at finding ways to try to get other people. They are currently trying to say if you sell a building in California in a 1031 exchange, they would like to tax that 20 years later if you sell the building. And we are very aware of California's long arm.

Mr. SUTTON. You asked the question——

Mr. ISSA. Yes.

Mr. SUTTON [continuing]. That if we disagreed with your first comment to speak up. I do not believe Congress has the obligation to interfere with State commerce. I believe it has got the power to do it, and it was given to it by the States because the States when this country was founded knew that the States were not good at doing this. It was a horrible mess in the Articles of Confederation.

Mr. ISSA. Okay. Well, let me ask one exit question because my time is expiring. Does anyone on this panel, are they willing to say here sort of under oath that if we fail to fix this, we are not, in fact, dooming brick and mortar shops who find themselves in California at over 8 percent disadvantage to the person that walks into the shop, looks at that TV, and then buys it on the internet and has an 8 percent advantage to somebody who is not paying the tax? Is there anyone that actually would tell me that we are not dealing with an inequity that is adversely affecting the normal flow of competitive commerce?

Mr. MOYLAN. I would respond briefly and say I think "doom" is perhaps a strong word. But you are getting at the issue of show rooming.

Mr. ISSA. Is it not unfair competition?

Mr. MOYLAN. Right, the inequity of the sort of show rooming issue. And this is something that I think is really important to point out that we have not yet in this hearing, which is that the show rooming concept——

Mr. ISSA. Is that not part of our——

Mr. GOODLATTE. The time of the gentleman has expired. All time has expired.

Mr. ISSA. Thank you, Mr. Chairman.

Mr. GOODLATTE. There is 1 minute and 56 seconds left in this vote. I apologize I will not be able to get down and say hello to the panelists. You all did a great job.

This concludes today's hearing, and I thank you all and everyone for attending.

Without objection, all Members will have 5 legislative days to submit additional written questions for the witnesses or additional materials for the record.

The hearing is adjourned.

[Whereupon, at 1:34 p.m., the Committee was adjourned.]

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