

Statement of

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The logo for NetChoice, featuring the word "NetChoice" in a bold, blue, sans-serif font. The "Net" is in a darker blue, and "Choice" is in a lighter blue. The logo is centered within a light blue rectangular background.

Testimony before the

United States Senate Committee on Commerce, Science, and Transportation

Hearing on:

"Marketplace Fairness: Leveling the Playing Field for Small Businesses"

August 1, 2012

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

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

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

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

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

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

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

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

Should online retailers have to collect sales tax? *Yes, and they already do.*

Just like all retailers, online stores must collect sales tax for every state where they have a physical presence. That's why Amazon.com adds sales tax to orders from customers in the 5 states where it has facilities. But Amazon and online retailers aren't required to collect tax for other states, leaving those customers to pay a "use tax" that states rarely enforce against individual taxpayers. This framework frustrates state tax collectors and businesses that compete with online retailers. But when we learn how this physical presence requirement evolved, it becomes clear why we should retain this standard for imposing new tax collection burdens on online retailers.¹

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

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

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



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

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

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

complicated that it presented an unreasonable burden on interstate commerce.

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

Quill was not concerned with "fairness." While some argued fairness as justification for tax collection, "[i]n contrast, the Commerce Clause and its nexus requirement are informed not so much by concerns about fairness for the individual [state] as by structural concerns about the effects of state regulation on the national economy."⁵

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

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

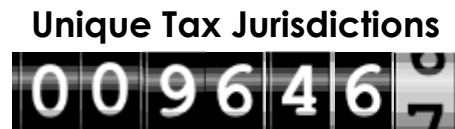
Quill also made it clear that states could simplify their sales tax systems and come back to the Supreme Court at any time to argue that they had eliminated the unreasonable burden on interstate commerce. But instead, a handful of states chose to skip the harsh judgment of the Court and go directly to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

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

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

⁵ *Id.* at 312 (emphasis added).

First, critics cite the fact that SSTP originally promised just one tax rate per state, but now accommodates over 9,600 local jurisdictions,⁶ each with its own tax rates and sales tax holidays.



That's up from 7,800 jurisdictions in the 20 years since *Quill*, and still growing. This makes the US a true outlier when it comes to sales tax jurisdictions. The European Union has 27 jurisdictions for Value Added Tax (VAT) and India lets each state have a single tax rate, but we are the only country where sales tax is controlled at the local government level.

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

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

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

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

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

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

Start with the US Department of Commerce's 2010 Electronic Commerce Industry Assessment, which reported total retail e-commerce of \$169 billion.⁷

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

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

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

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

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

Isn't there increased momentum to overturn Quill?

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

Big-box retail chains are pushing hard for federal legislation for a simple and predictable reason: it serves *their* interests. Even a little simplification helps a big-box retailer who must already collect tax for most states, as seen in this list. Big-box retailers now have expansive web-stores of their own and give

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

⁷ US Census Bureau E-Stats, <http://www.census.gov/econ/estats/2010/2010reportfinal.pdf>

⁸ US Census Bureau E-Stats, <http://www2.census.gov/govs/qtax/2011/q2t1.pdf>

⁹ Eisenach & Litan, *Uncollected Sales Taxes On Electronic Commerce: A Reality Check*, Empiris LLC (Feb. 2010), available at <http://bit.ly/EisenStudy>.

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

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

Why would Amazon.com support overturning Quill?

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

But there’s another reason for Amazon’s about-face: the company is changing its business model by adding distribution centers in new states to enable faster delivery to customers. Amazon is also adding drop-boxes in convenience stores and marketing daily deals to local merchants. As a result, Amazon will have physical presence in 14 states by 2014¹¹ – requiring Amazon to collect sales tax for more than half of all Americans. And as Amazon opens more distribution centers across the country they will continue to increase their tax collection requirements.

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

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

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

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

Is this debate really about “fairness” for small business?

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

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

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

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

For example, Amazon begins collecting sales tax in California on September 15, 2012 because it has physical presence there with its Kindle labs and new distribution centers. Even though customers in

one of Amazon's largest markets is facing the prospect of an 8% effective price increase, the company is not warning analysts about any impending drop in sales. In a conference call with equity analysts on July 26, 2012, Amazon executives fielded questions about the sales impact of collecting sales tax in more and more states. The company's CFO said:

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

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

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

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

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

For decades, "Main Street" retailers have been getting battered by Walmart and other national chains. To survive, many Main Street retailers have gone online with their own web stores or with e-commerce platforms to serve repeat customers and to find new customers across the country. For example, the specialty retailer SilverGallery.com has a warehouse and store—located on Main Street—in Waynesboro, Virginia. SilverGallery, which was featured in a Wall Street Journal article last year, does

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

some walk-in trade, but most sales come from their web store and other online channels.¹³ Online sales growth enabled SilverGallery to buy their building and increase employment, right there on Main Street.

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

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

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

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

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

What costs would a small business face if Congress forced them to pay sales tax to all 46 states? The SST's own Cost of Collection¹⁴ study found that a small business (under \$1M in annual sales) spends 17 cents for every tax dollar it collects for states. And even if tax software works as promised, that only helps with 2 cents of the 17 cents in costs per dollar collected. *That leaves small businesses with a 15% cost burden on every dollar they collect*, for things such as:

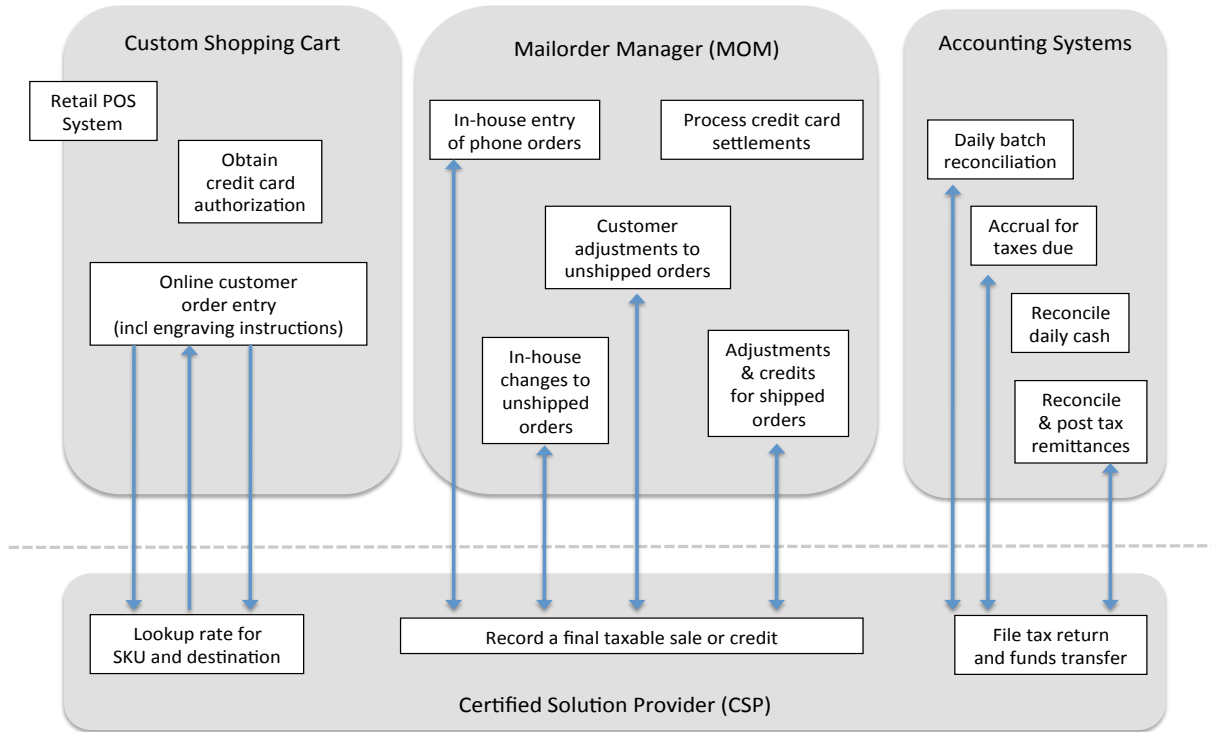
- Paying computer consultants to integrate new tax software into their home-grown or customized systems for point-of-sale, web shopping cart, fulfillment, and accounting
- Training customer support and back-office staff
- Answering customer questions about taxability of items, or sales tax holidays
-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

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

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

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

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



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

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

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

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

Would S 1832 create a new tax burden on businesses?

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

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

Arizona: "The Arizona transaction privilege tax is commonly referred to as a sales tax; however, the tax is on the privilege of doing business in Arizona and is not a true sales tax. Although the transaction privilege tax is usually passed on to the consumer, it is actually a tax on the vendor."¹⁶

California: "The sales tax portion of any sales and use tax ordinance adopted under this part shall be imposed for the privilege of selling tangible personal property at retail"¹⁷

Michigan: "there shall be collected from all persons engaged in the business of making sales at retail, by which ownership of tangible personal property is transferred for consideration, an annual tax for the privilege of engaging in that business equal to 6% of the gross proceeds of the business, plus the penalty and interest if applicable ..."¹⁸

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

Clearly, sales tax is due from *sellers* whose activities or locations create enough of a physical presence for a state to impose collection obligations. But if Congress overturns the *Quill* standard, businesses would be forced to pay a new tax to states where they have no physical presence. Most of those

¹⁶ <http://www.azdor.gov/business/transactionprivilegetax.aspx>

¹⁷ <http://www.boe.ca.gov/lawguides/business/current/btlg/vol1/ulsutl/7202.html>

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

businesses would pass the tax along to their customers, but make no mistake about it – the states will demand that businesses pay the new tax — whether or not their customers were charged.

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

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

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

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

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

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

S 1832 does not include adequate protection for small businesses

S 1832 includes a small seller exception that is appropriately mandated by Congress, as opposed to other legislation that leaves it to state tax administrators to set the exception level. But S 1832 sets the exception threshold at just \$500,000 in annual remote sales, a number that is far too low for retailers, whose entire expense and payroll must be paid from the margin on sales:

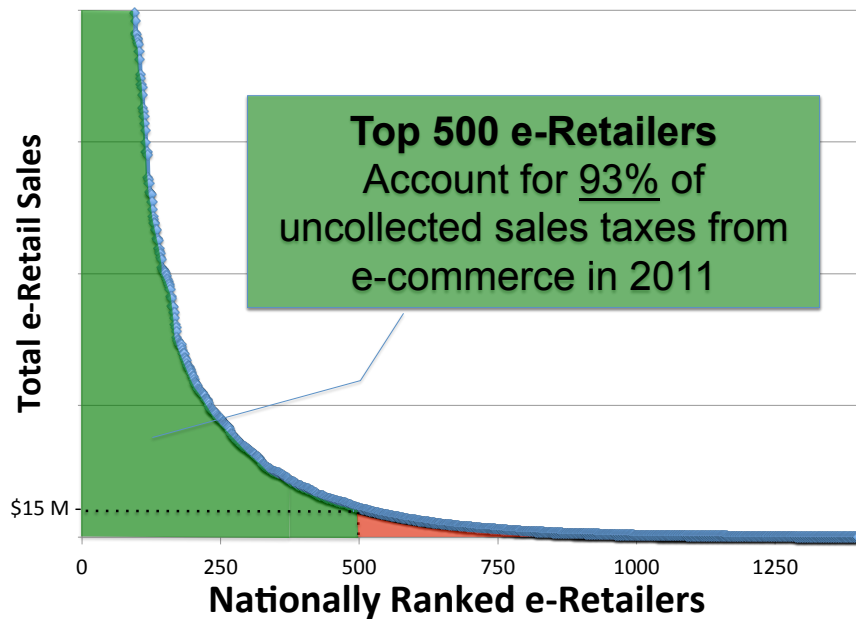
- \$500,000 in gross sales times 25% average gross margin leaves just \$125,000 to cover all other costs of running the entire business.
- All other costs would include advertising, rent, supplies, insurance, shipping, computers and programming, website, accounting, communications, travel, etc.
- If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

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

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

Economists Eisenach and Litan started with this Top 500 Guide when analyzing where each retailer already collected sales tax under *Quill's* physical presence standard. Using their analysis, we estimated that the Top 500 were responsible for 93% of the uncollected sales tax on US e-commerce in 2011, as shown in the graph below²⁰ (netchoice.org/top500collect).

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



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

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

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

Minimum Simplification Requirements lacking in S 1832:

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

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

- States should compensate all businesses for the fair and reasonable cost of collecting sales taxes, taking into account such elements as credit card fees and costs of software implementation and maintenance. Compensation was required in previous federal legislation to overturn the *Quill* physical presence standard, but was dropped in recent versions. S 1832 requires no compensation for either the integration costs or collection costs incurred by businesses in order to collect state taxes.
- Remote businesses should not be required to file sales tax returns for all 46 states. All states should accept a single sales tax return filed with a business’ home state. The home state revenue department would be responsible for distributing funds to remote states.
- Remote retailers should not be required to honor, but may observe, thresholds for sales tax calculation. (an example of a threshold is Massachusetts, where the first \$175 of any clothing item is exempt from sales tax²¹)
- Remote retailers should not be required to honor state-specific sales tax holidays.
- States should be required to adopt a single rule for sourcing sales. The SSTP originally maintained destination sourcing for all sales tax transactions. But to accommodate origin-based states, SSTP’s Governing Board voted to allow origin sourcing for in-state sales while requiring destination sourcing for remote sales. Such “dual sourcing” should not be permitted as part of any federal legislation overturning the physical presence standard.
- States must provide certified software for collection, filing, and remittance of taxes. But S 1832 requires only that states provide software “that identifies the applicable destination rate”. That leaves remote businesses to bear the full cost of integrating the rate lookup into their in-house systems and processes. And the business would also have to pay for software to handle filing and remittance in 46 different states.

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

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

S 1832 fails to hold states accountable to simplification requirements

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

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

§1341), where taxpayers are forced to use *state* courts to litigate disputes with state tax collection authorities – even on questions of whether a state is following federal law. It would be far better if federal courts had sole jurisdiction over disputes arising between states and remote businesses regarding a state’s compliance with federal law.

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

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

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

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

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

Conclusion

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