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# CONSTITUTIONAL LIMITATIONS ON STATES' AUTHORITY TO COLLECT SALES TAXES IN E-COMMERCE

## HEARING

BEFORE THE

## COMMITTEE ON THE JUDICIARY
## HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

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# CONSTITUTIONAL LIMITATIONS ON STATES' AUTHORITY TO COLLECT SALES TAXES IN E-COMMERCE

**WEDNESDAY, NOVEMBER 30, 2011**

HOUSE OF REPRESENTATIVES,
COMMITTEE ON THE JUDICIARY,
*Washington, DC.*

The Committee met, pursuant to notice, at 10:09 a.m., in room 2141, Rayburn House Office Building, the Honorable Lamar Smith (Chairman of the Committee) presiding.

Present: Representatives Smith, Sensenbrenner, Coble, Goodlatte, Lungren, Chabot, Issa, Pence, Forbes, King, Franks, Gohmert, Jordan, Poe, Chaffetz, Griffin, Ross, Adams, Quayle, Amodei, Conyers, Scott, Lofgren, Jackson Lee, Johnson, Quigley, Chu, Deutch, and Sánchez.

Staff present: (Majority) Travis Norton, Counsel; Ashley Lewis, Clerk; and (Minority) Norberto Salinas, Counsel.

Mr. SMITH. The Judiciary Committee will come to order.

Without objection, the Chair is authorized to declare recesses of the Committee at any time.

We welcome everyone here. We knew this subject was going to have and be of great interest and that is clearly reflected in the audience that we have here too. I will recognize myself an opening statement, then the Ranking Member. Then I will introduce the witnesses and then we will proceed to questions.

Black Friday marks the unofficial beginning of the holiday shopping season. But over the past few years many Americans have begun to wait until the Monday after Thanksgiving to shop.

On Cyber Monday, online merchants offer deals similar to the promotions shoppers find in Brick and Mortar stores on Black Friday with one exception. Online merchants usually do not collect a sales tax.

The Constitution grants Congress the exclusive power to regulate interstate commerce. By negative inference, a state may not unduly burden interstate commerce, a constitutional principle commonly referred to as the dormant Commerce Clause.

As applied to state tax policy, the dormant Commerce Clause prohibits a state from taxing a person with whom it lacks a substantial nexus. In tax terminology, nexus refers to the relationship between the taxing authority and the taxpayer.

In its 1992 decision in *Quill Corporation v. North Dakota* 19 years ago, the Supreme Court held that at least for purposes of col-

lecting sales tax a state lacks substantial nexus over a taxpayer that has no physical presence in the state.

The *Quill* court thus established a bright-line physical presence rule for sales tax nexus. In the *Quill* decision, the Supreme Court was concerned with burdens to America's small businesses.

It reasoned that without a bright-line physical presence rule for nexus, thousands of state and local taxing jurisdictions across America, each with their own unique tax bases and rates, would use vague concepts like economic nexus to impose sales tax collection requirements on businesses.

In the court's view, uncertainty about what jurisdiction has power to tax as well as compliance with numerous and difficult tax policies would place an undue burden on interstate commerce.

Today, we will hear testimony from online retailers, Brick and Mortar retailers and state governments about the impact of *Quill* on their operations.

This hearing will explore two issues—first, whether Congress should exercise its Commerce Clause power to enact sales tax reform legislation, and second, if Congress should act, how we can do so in a manner that does not increase administrative and compliance burdens on America's small businesses.

Some in the online retail community believe that physical presence is a fine rule for sales tax nexus. Online retailers typically maintain physical presence in only a handful of states and rely on common carriers to transport purchased goods to customers.

Most states, therefore, cannot require those online retailers to collect and remit sales tax.

Some argue that shielding businesses from the complex patchwork of sales tax laws was precisely the benefit of *Quill* and that Congress should take no action. But it is precisely this reality that frustrates Brick and Mortar retailers who claim to suffer a competitive disadvantage compared to their online counterparts.

State revenues are also affected by the *Quill* rule. Forty-five states and the District of Columbia have a sales tax.

Those jurisdictions also have a use tax equal to the sales tax rate which residents must pay for the usage, consumption or storage of goods purchased in a non-resident state and brought into the resident state.

For example, a shopper in Austin, Texas, who buys goods online from a retailer that lacks a physical presence in Texas is responsible to pay Texas use tax even though he or she pays no sales tax on his—on his transaction.

But states rely on taxpayers to self-report their purchases in other states, and states lack the resources and means to effectively police use tax avoidance. So online purchases usually escape taxation altogether.

Some believe that Congress should not come to the states' assistance. If a state chooses to impose a use tax it should also find a way to enforce it. Others would like to see Congress help states collect sales taxes on all transactions, thereby eliminating the need for use taxes.

I am aware of three legislative proposals that could give states nexus over online and other remote sellers. Ranking Member Conyers has reintroduced the Main Street Fairness Act this Congress.

Representative Steve Womack and Jackie Speier have introduced the Marketplace Equity Act, and most recently, Senators Enzi and Durbin introduced the Marketplace Fairness Act.

Although this is an oversight hearing, I invite our witnesses to comment on any of these three bills and I look forward to hearing from our distinguished panel of witnesses today and thank them in advance for their testimony.

Before I recognize the Ranking Member with his agreement, I would like to recognize a Member of the Committee for a unanimous consent request and the gentleman from California, Mr. Lungren, is recognized for that purpose.

Mr. LUNGREN. Thank you, Mr. Chairman. I am sorry I have to go to a hearing on the House Administration to decide how much we are going to cut every Committee and I can't miss that. [Laughter.]

Mr. SMITH. Maybe we don't—maybe we don't want you to go. [Laughter.]

Mr. LUNGREN. Well, if the gentleman won't allow me to go. No, what I asked unanimous consent that a constitutional analysis by Paul Clement on the proposed Streamlined Sales Tax legislation be made a part of the record.

Mr. SMITH. Without objection, so ordered.

[The information referred to follows:]

Bancroft PLLC

# Constitutional Difficulties of Proposed Streamlined Sales Tax Legislation

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# Executive Summary

This white paper addresses constitutional difficulties presented by the Main Street Fairness Act, H.R. 5660, 111th Cong. (2010) (the "Main Street Act"), and other bills that would override *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), by purporting to consent to the Streamlined Sales and Use Tax Agreement ("SSUTA"). *Quill* made clear that such a bill would constitute a valid exercise of Congress's commerce power. But a bill overriding *Quill*, just like any other law regulating interstate commerce, also must be consistent with the Constitution's other structural provisions and its protections of individual rights.

*Quill* gave Congress a green light to authorize States to tax remote sales under the Commerce Clause, not a blank check to do so in a manner repugnant to the Constitution's other limitations and guarantees. And in our view, the Main Street Act would give rise to at least three serious constitutional problems.

1. The Main Street Act is not an approvable interstate compact. The Main Street Act purports to consent to the SSUTA as an interstate compact. But the SSUTA is not a "compact" within the meaning of Art. I, § 10, cl. 3. Rather, it would be properly classified as a "Treaty, Alliance, or Confederation" between States, which the Constitution flatly prohibits. *See* U.S. CONST. art. I, § 10, cl. 1. The Main Street Act proposes to delegate to SSUTA Member States the ongoing powers to tax retail sales made by out-of-state retailers, even if the retailer is in a non-compacting State; to decide which states can participate in this scheme and which cannot; and to decide which sellers are "small" and therefore exempt from being compelled to collect taxes under this scheme. These are ongoing powers over matters of substantial public importance that are peculiarly national in character. 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 tax policy.

2. The Main Street Act violates the Appointments Clause. The Appointments Clause commands that "any appointee exercising significant authority pursuant to the laws of the United States is an 'Officer of the United States'" and therefore must be appointed by the "President alone, in the Courts of Law, or in the Heads of Departments." U.S. CONST. art. II, § 2, cl. 2; *Buckley v. Valeo*, 424 U.S. 1, 125 (1976). The Main Street Act violates this command by delegating extraordinary and quintessentially federal power to the SSUTA's Governing Board, which Member States appoint — not the President. The Board would be empowered to decide (1) whether to permit other States to regulate interstate commerce in a manner otherwise forbidden by the Commerce Clause; and (2) which retailers in those states should be subject to taxation and which should be exempt. A "board" of unappointed officials has never exercised authority that is this extensive, national in character, or politically charged.

3. The Main Street Act will lead to Due Process violations. The Due Process Clause prohibits a state from taxing an out-of-state business unless that business "purposefully avails" itself of the benefits and protections of a state's laws and market. *Quill*, 504 U.S. at 307–08.

The Main Street Act authorizes Member States to tax remote sellers even when the seller has only isolated and attenuated contacts with that State. Although the Main Street Act's "small seller exception" will alleviate the Due Process problem, it will not eliminate it. The SSUTA Board has announced that a seller is only "small" if its gross national remote sales fall under a low threshold, likely $500,000 and ratcheting downwards over time. Myriad retailers that focus on a particular geographic region will cross this threshold and thus be subject to every Member State's tax authority — even when the retailer makes only isolated and sporadic sales to some of those jurisdictions. This result cannot be squared with Due Process.

# Background

## A. Constitutional Limits on State Taxation of Out-of-State Retailers

"The Commerce Clause and the Due Process Clause impose distinct but parallel limitations on a State's power to tax out-of-state activities." *MeadWestvaco Corp. v. Illinois Dep't of Revenue*, 128 S. Ct. 1498, 1505 (2008). In *National Bellas Hess, Inc. v. Dep't of Revenue of Illinois*, 386 U.S. 753 (1967), the Supreme Court addressed a state tax implicating both constitutional provisions. Illinois required an out-of-state retailer, with no physical presence in Illinois, to collect and remit a use tax on a mail-order sale made to an in-state customer. The Supreme Court held that this remote tax violated both the Due Process Clause and the Commerce Clause. *Id.* at 758–60.

In *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the Supreme Court revisited the constitutionality of remote taxation in light of intervening developments in its Due Process and Commerce Clause jurisprudence. In *Quill*, the Supreme Court overruled *Bellas Hess* with respect to Due Process, finding that North Dakota had sufficient minimum contacts to impose a remote tax on the large catalog retailer in that case, which was "engaged in continuous and widespread solicitation of business within" North Dakota. *Id.* at 308. But the Court reaffirmed *Bellas Hellas*'s "physical presence" rule under the Commerce Clause. The Court found that the tax unduly burdened interstate commerce because Quill lacked an in-state physical presence, and thus that it violated the Court's dormant Commerce Clause jurisprudence. *Id.* at 318. The Supreme Court explained that if every State could impose a use tax like North Dakota's, retailers would be forced to comply with "'a virtual welter of complicated obligations'" regarding different tax rules, rates, exemptions, and administrative requirements which "might be imposed by the Nation's 6,000-plus taxing jurisdictions." *Id.* at 313 n.6 (*quoting Bellas Hess*, 386 U.S. at 760).

The Court noted in *Quill* that because North Dakota's tax violated the Commerce Clause but not Due Process, Congress was free to exercise its plenary authority over interstate commerce "to decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes." *Id.* at 318; *see also id.* at 320 (SCALIA J., concurring in part) ("Congress has the final say over regulation of interstate commerce, and it can change the rule . . . by simply saying so.").

*Quill* thus made clear that federal legislation overriding *Quill* would be a permissible exercise of Congress's commerce power. But that is the beginning, not the end, of the constitutional analysis. A federal law regulating commerce is unconstitutional if it violates an individual's rights, *see, e.g., United States v. Stevens*, 130 S. Ct. 1577 (2010), or if it impermissibly undermines the Constitution's core structural principles, *see, e.g., New York v. United States*, 505 U.S. 144 (1992). "*Quill*-override legislation" thus must comport with all of the Constitution's limitations and guarantees.

### B. The Main Street Act and the SSUTA

1. In response to *Quill*, some States have joined to convince Congress to consent to the SSUTA as an interstate compact and to override *Quill*'s Commerce Clause holding for Member States, thereby permitting those States to tax foreign retailers. *Quill* override legislation was introduced in the 106th, 107th, 108th, 109th, 110th, and 111th Congresses.[1] This paper uses the Main Street Act as a model of likely future legislation.

The Main Street Act purports to consent to the SSUTA as an interstate compact and to authorize SSUTA Member States to require out-of-state retailers to "collect and remit sales and use taxes with respect to remote sales." Main Street Act §§ 2, 4(a). Authorization under the Main Street Act would come into force when (1) 10 States comprising at least 20% of the population are SSUTA "Member States"; (2) the SSUTA Board has taken certain steps, such as implementing a uniform taxation database and promulgating rules regarding dispute resolution; (3) Member States' tax codes satisfy certain "[m]inimum simplification requirements." *Id.* at §§ 4(a)(1)–(3).

Member States would not be authorized to tax any out-of-state seller falling within a "small seller exception." *Id.* at § 4(a)(1). The Main Street Act does not define "small seller," and thus does not define which businesses are taxed and which are exempt. Instead, the Act would delegate to the SSUTA Board power to set "[a] uniform rule to establish [the] small seller exception." *Id.* at § 7(a)(17). The SSUTA provides that the Board "shall develop" a threshold to define whether a seller is "small." SSUTA § 610.

This threshold "shall be set at a relatively low level and over time adjusted downward" so that the only exempt sellers are those making "isolated or occasional sales" out of state. *Id.* The SSUTA provides that the threshold will be based on "the total annual dollar volume of gross remote sales nationwide," not sales volume in a particular taxing state. *Id.* The Board is currently considering setting the initial threshold at $500,000 in gross remote sales, and reducing it to $100,000 within four years. Kansas Motion to Adopt a Rule Relating to a Small Seller Exception, RP10012, at 1–2 (Oct. 27, 2010) ("Kansas Proposal").

The Main Street Act's authorization to tax remote sales "terminate[s]" for all States if any of the minimum simplification requirements "cease to be satisfied" or if the SSUTA Board adopts an amendment to the SSUTA that "is not within the scope of the administration of sales and use taxes." Main Street Act § 4(b)(1). Authorization also terminates as to any particular State that "no longer meets the requirements for Member State status." *Id.* at § 4(b)(2). Provided that these conditions are satisfied, however, the Main Street Act would authorize SSUTA Member States to impose tax burdens that specifically target and impact out-of-state retailers — *even those located in non-compacting States*. This effect on out-of-state retailers is not incidental; it is the *raison d'être* of the proposal. States are already free to require in-state retailers to collect

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[1] *See* Main Street Fairness Act, H.R. 5660, 111th Cong. (2010); Sales Tax Fairness and Simplification Act, S. 34, 110th Cong. (2007); Streamlined Sales Tax Simplification Act, S. 2153, 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. 512, 107th Cong. (2001); Internet Tax Simplification Act, H.R. 4460, 106th Cong. (2000).

and remit taxes at whatever rate (or in whatever manner) States choose. To impose these tax burdens on out-of-state retailers, by contrast, requires congressional action, and the SSUTA seeks to ensure that a critical mass of States act together to avoid retaliation.

To become a member of the SSUTA, a State must simplify its sales and use tax laws in several respects. A State must administer taxes at the state level, not the local level, SSUTA § 301; eliminate intra-state variation in the tax base, *id.* at § 302; use a centralized database for registering sales and processing remittances, *id.* at § 303; use uniform "sourcing rules" to determine which jurisdictions may tax a particular sale, *id.* at §§ 309–315; and use uniform definitions in their sales and use tax code, *id.* at §§ 316, 327, such that any Member State wanting to tax (or exempt) sales of "clothing," for example, must define "clothing" the same way.[2]

2. A "Governing Board" implements and oversees the operation of the SSUTA. The Governing Board comprises "representatives of each member state," with each Member State able to appoint up to four "members of the executive or legislative branches of the state" to the Board. *Id.* at § 806. Except for membership decisions, which require a "three-fourths vote of the entire governing board," the Governing Board ordinarily may act on a "vote of a majority of the governing board present and voting." *Id.* at §§ 804, 806. There is no minimum quorum requirement.

The Board controls membership in the SSUTA itself, which is a significant power because the Main Street Act only authorizes Member States to tax remote sales. Main Street Act § 4(a)(1). The Board may admit a new Member State if, by three-fourths vote, it determines that the State is fully "in compliance" with the SSUTA's requirements. SSUTA § 804.[3] If three-fourths of the Board determines that a Member State is no longer "in compliance," however, the Board may sanction that State by expulsion from the Agreement or by imposing "other penalties." *Id.* at § 809(A). Membership decisions are subject to review in federal court only under the deferential "arbitrary and capricious" review standard. Main Street Act § 6(a), (c)–(d).

The Act empowers the Board to craft the critical "small seller exception." *Id.* at § 7(a)(17). The Board will promulgate a rule to define this exception. SSUTA § 610; *see also id.* at § 806 (rulemaking authority). The Board thus has the power to decide which out-of-state retailers will be exempt and which will be subject to Member States' tax authority.

The Main Street Act also empowers the Board to "promulgate rules" for dispute resolution. Main Street Act § 4(a)(2)(B)(vi); SSUTA § 1001. The Board is not, however, bound by the result of the dispute-resolution process. Rather, after "consideration" of the results, the Board

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[2] Congress could not force such changes on the states directly. Even if the Commerce Clause authorized such legislation, other constitutional provisions would forbid it. For example, direct congressional efforts to move all taxation authority to the state level, not local level, would presumably run afoul of federalism principles. *See New York v. United States*, 505 U.S. 144, 161 (1992).

[3] The SSUTA allows States that are only partially "in compliance" to become "associate members." SSUTA § 704(C). The Main Street Act, however, does not authorize "associate members" to tax remote sales. *See* Main Street Act §§ 4(a)(1), 10(3)(B).

resolves disputes by its own vote. SSUTA § 1003. The Board's resolution of a dispute is "final and not subject to further review." *Id.* And the Board has the power to amend the SSUTA itself, by three-fourths vote, *id.* at § 901, although Congress's consent to the SSUTA terminates if the Board amends the SSUTA in a manner that "is not within the scope of the administration of sales and use taxes," Main Street Act § 4(b)(1).

# Analysis

## I. THE SSUTA IS NOT AN APPROVABLE INTERSTATE COMPACT

The Constitution imposes two complementary limitations on States' ability to enter into external agreements with one another. The Compact Clause provides that "[n]o State shall . . . enter into any Agreement or Compact with another State" without congressional consent. U.S. CONST. art. I, § 10, cl. 3. The State Treaty Clause provides, however, that a State many not enter into a "Treaty, Alliance, or Confederation" in any circumstances — even with congressional approval. U.S. CONST. art. I, § 10, cl. 1; *see also Rhode Island v. Massachusetts*, 37 U.S. 657, 724–25 (1838) ("no power under the government could make such an act valid"). The distinction between an "Agreement or Compact," on one hand, and a "Treaty, Alliance, or Confederation," on the other, is thus of constitutional dimension.

The Supreme Court has never faced a case challenging a congressionally-approved agreement as an unconstitutional treaty. Accordingly, there is no Supreme Court precedent directly on point. Congressional judgment, rather than accumulated judicial precedent, will be a particularly crucial first step in assessing the constitutionality of a bill enabling the SSUTA. *See* Felix Frankfurter & James M. Landis, *The Compact Clause of the Constitution — A Study in Interstate Adjustments*, 34 YALE L.J. 685, 694–95 (1925) ("Congress is the appropriate organ for determining" whether an interstate arrangement is a permitted compact or an impermissible treaty). The Constitution's origins, history, and structure show that the Compact Clause was intended to facilitate the resolution of regional disputes, not to be a constitutional back door through which a subset of States and state officials may make policy directly and substantially affecting non-compacting States and their residents. A bill enabling the SSUTA, therefore, would not create a valid interstate compact.

### A. The Compact Clause Was Intended as a Limited Tool for Resolving Regional Disputes

For the Framers, the distinction between the Compact and State Treaty Clauses was so "obvious" and "fully developed" that the Federalist Papers "passed [it] over without remark." The Federalist No. 44 (Madison). Indeed, during the Constitutional Convention, there was no discussion whatsoever of the interplay between the two clauses. *See* Abraham C. Weinfeld, *What Did the Framers of the Federal Constitution Mean By "Agreements or Compacts"?*, 3 U. CHI. L. REV. 453, 453–57 (1936).

The distinction between a "Treaty" and a "Compact" was "obvious" to the Framers because Emmerich de Vattel had developed this distinction in his writing. Vattel was "greatly admired" as the "most popular" writer on the law of nations in the late Eighteenth Century. 1 CHANCELLOR KENT, COMMENTARIES ON AMERICAN LAW 18 (1826). His influence on the Framers is well-documented. *See, e.g.*, David E. Engdahl, *Characterization of Interstate Arrangements: When Is a Compact Not a Compact?*, 64 MICH. L. REV. 63 (1965); Weinfeld, *supra*, at 458–64; *see also* Charles G. Fenwick, *The Authority of Vattel, Part I*, 7 AM. POL. SCI.

REV. 395, 395 (1913) ("Vattel's treatise [was] the reference work of the statesman, and the text from which the political philosopher drew inspiration."). Vattel's seminal work, *The Law of Nations*, was "continually in the hands of the members" of the Continental Congress, who "entertained a high and just esteem" for the work. Letter of Benjamin Franklin to Charles Dumas, Dec. 19, 1775, in 2 REVOLUTIONARY DIPLOMATIC CORRESPONDENCE OF THE UNITED STATES 64 (1889).

Like the Framers, Vattel distinguished between "treaties" ("*traités*") and mere "agreements" or "compacts" ("*accords*" or "*pactions*"). 1 EMMERICH DE VATTEL, DROIT DES GENS, Bk. 2, Chp. XII §§ 152, 153 (1758). Vattel explained that the critical difference between the two types of agreement is that "compacts" are "accomplished by one single act, and not by repeated acts; [they] are perfected in their execution once and for all." *Id.* at § 153. "Treaties," by contrast, "receive a successive execution whose duration equals that of the treaty." *Id.* Somewhat confusingly, Vattel described matters that could be resolved "by one single act," *i.e.*, by a compact, as "transitory matters." *Id.* But he used this word as a term of art: As he explained, pacts "that have no relation to the performance of reiterated acts, but merely related to transitory and single acts which are concluded at once, . . . those conventions, those compacts, which are accomplished once and for all, and not by successive acts, — are no sooner executed than they are completed and perfected. If they are valid, they have in their own nature a perpetual and irrevocable effect." *Id.* at § 192.

Writing shortly after the Founding, the leading constitutional commentator Henry St. George Tucker agreed that Art. I, § 10 reflected Vattel's distinction between "treaties" and mere "agreements" or "compacts."[4] Citing Vattel, Tucker explained that, for the Framers, a "treaty" was understood "to relate ordinarily to subjects of great national magnitude and importance," while "agreements, or compacts" were understood to "concer[n] transitory or local affairs." 1 HENRY ST. GEORGE TUCKER, BLACKSTONE'S COMMENTARIES, App. at 309–10 & n.* (1803).

Tucker observed that a defining characteristic of transitory "compacts" was that they "cannot possibly affect any other interest but that of the parties." *Id.* at 310. Tucker gave as an example of an interstate "compact" the 1785 Compact between Maryland and Virginia, which settled the placement of the border between the two States and their respective rights vis-à-vis the boundary Potomac River. *Id.*; *see also Virginia v. Maryland*, 540 U.S. 56 (2003). The Maryland-Virginia Compact was "transitory," as it was "accomplished by one single act, and not by repeated acts; [they] are perfected in their execution once and for all." 1 VATTEL, *supra*, at § 153. Furthermore, because the Compact related only to the placement of the boundary between the two signatory States, it could not "possibly affect any other interest but that of the parties." 1 TUCKER, *supra*, at 310.

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[4] Founding-era dictionaries do not illuminate the distinction between a treaty and a compact. *See, e.g.*, SAMUEL JOHNSON, A DICTIONARY OF THE ENGLISH LANGUAGE (1783) ("agreement" means "[c]oncord," [c]ompact," or "bargain"; "compact" means "[a] contract; an accord; an agreement"; and "treaty" means "[a] compact of accommodation relating to public affairs").

Other "compacts" entered into under the Articles of Confederation confirm that, for the Framers, a "compact" was an agreement between neighboring States to resolve permanently a dispute relating to the States' shared border.[5] Under Art. VI of the Articles of Confederation, States could enter into compacts with one another, provided the Congress consented. In addition to the 1785 Maryland-Virginia Compact, several other bordering States entered into "agreements" with one another. *See* Agreement between Pennsylvania and Virginia, Aug. 31, 1779, 10 Hening's Va. Stat. 1822, at 533–35; Agreement between Pennsylvania and New Jersey, Apr. 26, 1783, 11 Pa. Stat. 1782, ch. 1035, at 151; Convention between Georgia and South Carolina, 1 Cooper's S.C. Stat. 1836, at 411. Consonant with Tucker's understanding of Art. I, § 10, and Vattel's definition of the term, each of these "compacts" related to the final resolution of a boundary dispute via a one-time, permanent agreement.

For 130 years following the Founding, Congress and the States applied the compact clause, in accord with the original understanding, to refer to (1) "transitory" interstate agreements, *i.e.*, dispositive agreements resolving interstate disputes, 1 VATTEL, *supra*, at § 153; that (2) addressed "local affairs" that "cannot possibly affect any other interest but that of the parties," 1 TUCKER, *supra*, at 310. Between 1792 and 1921, Congress consented to 36 interstate compacts, all but one of which dispositively resolved a boundary dispute between neighboring States. Jill E. Hasday, *Interstate Compacts in a Democratic Society: The Problem of Permanence*, 49 FLA. L. REV. 1, 4–5 (1997); *see also* Frankfurter & Landis, *supra*, at 735–48 (briefly summarizing each compact). The only "exception" was the Virginia-West Virginia compact of 1862, which separated the latter from the former, settling that border and dividing the public debt between the two States. Hasday, *supra*, at 4–5 & n.14; *see also Virginia v. West Virginia*, 78 U.S. 39 (1870).

### B. The Supreme Court Has Never Approved a Compact Permitting Member States to Exercise Ongoing Power with a National Scope

In its first significant encounter with the scope of the Compact Clause, the Supreme Court turned directly to Vattel. The Court quoted in full the relevant passages from *Droit des Gens*, and explained that, "[a]fter reading these extracts, *we can be at no loss to comprehend the intention of the framers of the Constitution* in using all these words, 'treaty,' 'compact,' 'agreement.'" *Holmes v. Jennison*, 39 U.S. 540, 572 (1840) (plurality opinion) (emphasis added).

In its modern jurisprudence, however, the Supreme Court has reviewed interstate agreements relatively deferentially. Although the Court has departed in some respects from the original

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[5] Practice during the Colonial period further demonstrates that the Compact Clause was understood as a mechanism states could use, with Congress's consent, to resolve regional disputes. Nine inter-colonial "agreements" were entered into, each of which was a "transitory" agreement resolving a boundary dispute between neighboring colonies. *E.g.*, New York-Connecticut Boundary Agreement of 1683, 3 Conn. Col. Rec. 1673–1776, at 330, 1 Report of the Regents of the University on the Boundaries of the State of New York 58 (1874); *see also* Frankfurter & Landis, *supra*, at 730–32 (summarizing the agreements).

understanding of the Compact Clause, it has never gone so far as to approve an agreement, like the SSUTA, that would allow state-appointed officials prospectively to exercise federal power in a way that would significantly affect non-compacting States.

First, in *Virginia v. Tennessee*, 148 U.S. 503 (1893), the Supreme Court in dicta explained that some interstate agreements are so minor that they do not rise to the level of an "Agreement or Compact" within the meaning of Art. I, § 10, and thus do not require congressional approval at all. In *Virginia v. Tennessee*, the agreement was trivial indeed: The party States agreed merely to physically mark their border, as the pre-existing border markings had become indistinct over time; but the States did not agree to accept the new border markings as correct or legally binding. *See id.* at 521–22. The Supreme Court stated that Congress did not need to consent to the agreement because the Compact Clause was "directed to the formation of any combination tending to the increase of political power in the States, which may encroach upon or interfere with the just supremacy of the United States." *Id.* at 519. The boundary-marking agreement had no such effect. *Id.*

The Supreme Court has since adopted the *Virginia v. Tennessee* dicta as the test for determining whether an interstate agreement requires congressional approval. Applying this test, the Supreme Court has defined a "non-compact" as an agreement that does not "purport to authorize the member States to exercise any powers they could not exercise in its absence." *U.S. Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452, 473 (1978). The agreement merely to mark the boundary line in *Virginia v. Tennessee*, for example, was not a "compact" because it had "no effect upon the political influence of either State, it may simply serve to mark and define that which actually existed before, but was undefined and unmarked." 148 U.S. at 520. The Multistate Tax Compact similarly did not purport to increase the power of the party States. The Multistate Tax Compact created an organization with the mere power to promulgate rules that were "advisory only," as each compacting State "ha[d] the power to reject, disregard, amend, or modify" the rules and they would have "no force in any member State until adopted by that State in accordance with its own law." *Multistate Tax Comm'n*, 434 U.S. at 457.[6] *See also New York v. O'Neill*, 359 U.S. 1 (1959) (Uniform Law to Secure the Attendance of Witnesses from Within or Without a State in Criminal Proceedings is not a "compact").

Second, tacitly departing from Vattel's conception of compacts as dispositive, one-time agreements, the Supreme Court has validated several arrangements that created interstate compact agencies to execute and administer the agreement on an ongoing basis. *See, e.g., Hess*

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[6] Most non-compact interstate arrangements create uniform procedures by which states may cooperate to solve problems that arise when residents move from one state to another. *E.g.*, Driver's License Compact, Del. Code Ann. tit. 21, § 8101 (procedures for party states to inform one another that a non-resident has violated its traffic laws). Congress has consented to uniform agreements for cooperation in law enforcement, 4 U.S.C. § 112, and there are numerous such agreements, *e.g.*, Interstate Compact for Adult Offender Supervision, Ky. Rev. Stat. Ann. § 439.561; Interstate Agreement on Detainers, Conn. Gen. Stat. § 54-186. *Multistate Tax Comm'n* establishes that Congress's consent is unnecessary, as these cooperative efforts do not purport to allow a party state to exercise any power it could not exercise absent the agreement. *See* 434 U.S. at 473.

*v. Port Auth. Trans-Hudson Corp.*, 513 U.S. 30 (1994); *Lake Country Estates, Inc. v. Tahoe Regional Planning Agency*, 440 U.S. 391 (1979). Although such interstate compact agencies are relatively commonplace, the Supreme Court has not squarely addressed the question whether they are consistent with the original meaning of the Compact Clause. *Cf. INS v. Chadha*, 462 U.S. 919, 944 (1983) (the judicial inquiry is "sharpened rather than blunted" by the fact that a novel form of governance has "appear[ed] with increasing frequency in statutes").

### C. In Light of these Principles, the SSUTA Would Not Constitute an Approvable Interstate Compact

1. As a threshold matter, the SSUTA plainly cannot be deemed a "non-compact." An interstate agreement does not require congressional consent if it does not "propose to authorize the member States to exercise any powers they could not exercise in its absence." *Multistate Tax Comm'n*, 434 U.S. at 473. The Main Street Act authorizes SSUTA Member States to tax any out-of-state seller, which Member States could not do absent federal authorization. *See Quill*, 504 U.S. at 318. The SSUTA thus at the very least requires congressional authorization. The critical question is thus whether the SSUTA's proposed scheme for giving a subset of States ongoing authority to affect commerce in non-compacting States crosses the constitutional line and, in fact, renders the agreement an impermissible state treaty.

2. The SSUTA is poles apart from anything the Framers understood to be a "compact." The SSUTA bears no resemblance to a dispositive "transitory" agreement "accomplished by one single act," "perfected in their execution once and for all." 1 VATTEL, *supra*, at § 153. To the contrary, the SSUTA contemplates "repeated acts," with "a successive execution whose duration equals that of the treaty," here, into perpetuity. *Id.* The ongoing nature of the SSUTA is embodied in the Governing Board, which is granted significant prospective power to alter, implement, and interpret the Agreement. *See* SSUTA §§ 804, 806.

To be sure, modern compacts like the Port of New York Authority Compact also create ongoing public agencies requiring "repeated acts." But the particular compact agencies the Court has faced have arisen in agreements that are modern analogs to the border agreements understood at the Framing and into the modern era as the quintessential interstate "compacts."

For example, the New York-New Jersey Port Authority and the Tahoe Regional Planning Association resolve the conflicts that inevitably arise when multiple sovereigns jointly possess and govern shared borders. *See Hess*, 513 U.S. at 41 ("From the point of view of geography, commerce, and engineering, the Port of New York is an organic whole. Politically, the port is split between the law-making of two States, independent but futile in their respective spheres. . . . Plainly the situation could not be adequately dealt with except through the coordinated efforts of New York, New Jersey, and the United States." (internal quotation marks omitted)). Similarly, some interstate compacts form commissions to address the joint management of a natural resource, such as a river basin, that is shared by bordering States in a region. *E.g.*, *West Virginia ex rel. Dyer v. Sims*, 341 U.S. 22 (1951) (addressing the Ohio River Valley Water Sanitation Compact). Notwithstanding the novelty of the compact agency, these compacts are similar in function and purpose to the Maryland-Virginia Compact of 1785 and compacts entered into since: They provide regional solutions for regional problems.

3. The SSUTA, by contrast, is national — not regional — in character and scope. Indeed, the Court has never faced a "compact" remotely like the one envisioned by the Main Street Act. The *Quill* rule does not peculiarly affect one region of the country; it applies uniformly to all States. The States in the compact do not share any regional interest or identity; they just share an interest in having a particular tax policy. Any one of the States can tax any in-state retailer in any manner it chooses, within the bounds of the Constitution.

The SSUTA seeks to ensure that a critical mass of States can agree to tax out-of-state retailers in a manner that does not unduly disadvantage the taxing States. Main Street Act § 4(a)(2)(A); SSUTA § 701. The Main Street Act thus must give SSUTA Member States authority to impose taxes on sellers in compacting and non-compacting States alike. *See* Main Street Act § 4(a)(1). And it gives the SSUTA Board the extraordinary power of deciding which retailers should be exempt from Member States' tax authority, pursuant to the "small seller exception." The Main Street Act would mark a far greater departure from the original understanding of an interstate "compact" than any interstate agreement ever approved by the Supreme Court.

The SSUTA also does not relate to "local affairs" that "cannot possibly affect any other interest but that of the parties." 1 TUCKER, *supra*, at 310. The SSUTA would directly and substantially affect the interest of non-party States. Indeed, the animating purpose of the Main Street Act is to permit party States to impose taxes on *out-of-state* retailers — even when the retailer is located in a non-compacting State. And remote retail sales constitute a not insubstantial portion of the entire national economy. In 2007, $127 billion in retail sales were recorded online alone. U.S. Census Bureau, 2007 E-Commerce Multi-Sector Report 1 (May 28, 2009).

The SSUTA's national character is further exemplified by the requirement, in both the Main Street Act and the SSUTA itself, that the "compact" does not come into effect until there is a critical mass of "at least ten [member] states comprising at least twenty percent of the total population." Main Street Act § 4(a)(2)(A); SSUTA § 701. The SSUTA's taxation powers thus arise only when one-fifth of States, by number and population, are Member States. This provision guarantees that, from the outset, the SSUTA will have nationwide scope and will wield enormous economic clout. Indeed, even if only the minimum number of States join the SSUTA, the GDP of the SSUTA-zone States likely would be on a par with the GDP of France.[7]

The SSUTA's national character stands in stark contrast to compacts entered into at the time of the Founding or approved of since by the Supreme Court. Under a traditional bilateral compact, such as the Maryland-Virginia Compact, or a multilateral regional compact, such as the Ohio River Valley Water Sanitation Compact, each compacting State's extraterritorial policy influence is limited to the borders of the other compacting States which, by definition, have agreed to be bound in such a manner. *E.g.*, *Texas v. New Mexico*, 482 U.S. 124, 128 (1987)

[7] In 2008, the United States GDP was $14.33 trillion. CIA World Fact Book, GDP – Official Exchange Rate (2008). Assuming that one-fifth of the States and population account for one-fifth of the GDP, SSUTA-zone States would have a GDP of $2.87 trillion. The GDP of France is $2.97 trillion. *Id.* Even if the SSUTA-zone States accounted for only one-tenth of the United States' GDP, Member States' GDP would be on a par with Canada's GDP. *Id.* ($1.56 trillion).

("[A] Compact is, after all, a contract." (internal quotation marks omitted)). But the SSUTA's direct impact is not so limited, as the authorization under the Main Street Act is to tax any remote sale — even if made from a non-compacting State.

The Main Street Act does not merely authorize States to impose such a tax. Instead, the Main Street Act seeks to ensure that a critical mass of States agrees to a simplified mechanism to impose the taxes. That critical mass of States, in turn, will make it difficult for non-member States to resist joining the compact. Whether they join or not, a significant number of other States will be taxing their retailers. The *likely* result will be that most States will seek to join the SSUTA, and thus the SSUTA will be setting tax policy on an ongoing basis for much of the Nation. The *inevitable* result, however, will be an ongoing agreement among States that share nothing other than an interest in tax policy.

### D. The Constitution's Structure Confirms that the Compact Clause Is Not an Expansive Tool for States to Craft National Policy

1. The SSUTA also would run contrary to the Constitution's basic structural principles by permitting parties to the SSUTA to develop an alternative, and largely unchecked, mechanism through which they could directly and substantially affect non-compacting States. The Constitution creates a National government that has the power to create law that is binding in every State, even if that State's representatives in the House or Senate did not vote for the law. U.S. CONST. art. VI, cl. 2. But the Constitution tightly restricts this substantial power, *inter alia*, through bicameralism, presentment, and representative election of Congress and the President. The SSUTA, by contrast, gives a subset of States authority to set policy on an issue with an avowed purpose of impacting retailers in non-compacting States. The result is a mode of lawmaking foreign to our Constitution.

First, the interrelated requirements of bicameralism and presentment are central to the Constitution's plan: The Constitution creates two Houses of Congress and provides that, to become law, "[e]very bill" must pass both Houses and "be presented to the President of the United States," who may either make the bill law or veto it, subject to override by two-thirds vote of both Houses of Congress. U.S. CONST. art. I, §§ 1, 7, cls. 2–3. These provisions reflect the Framers' concern "that legislation should not be enacted unless it has been carefully and fully considered by *the Nation's* elected officials." *Chadha*, 462 U.S. at 948–49 (emphasis added). Furthermore, the President's role in forming legislation was seen as crucial because "the President elected by all the people is rather more representative of them all than are the members of either body of the Legislature whose constituencies are local and not countrywide." *Myers v. United States*, 272 U.S. 52, 123 (1926).

Second, the Framers also "conceived of a Federal Government directly responsible to the people, possessed of direct power over the people, and chosen directly, not by States, but by the people." *U.S. Term Limits, Inc. v. Thornton*, 514 U.S. 779, 821 (1995). The Constitution thus provides that Representatives are to be "chosen every second Year by the People of the several States." U.S. CONST. art. I, § 2, cl. 1. The Senate also was representative of the people, although Senators were originally appointed indirectly by the people's representatives in the Legislatures of the several States. U.S. CONST. art. I, § 3, cl. 1. "Following the adoption of the

Seventeenth Amendment in 1913," however, the representative ideal "was extended to elections for the Senate." *Thornton*, 514 U.S. at 821. The Constitution thus ensures that national law is made by Senators and Representatives who are chosen directly "by the people" — not by a subset of States operating as States. U.S. CONST. amend 17.

The Framers also set forth in detail the apparatus for executing national policy. Crucially, the Constitution vests "[t]he executive Power" in the President who is elected, albeit indirectly, by the people of the entire Nation. U.S. CONST. art. II, § 1, cls. 1–4, amend. 12. Among the President's powers is his power over appointment of executive branch officers, and thus to control the execution of federal law by his subordinates: The Constitution vests the President with power to nominate and, "with the Advice and Consent of the Senate," to "appoint Ambassadors, other public Ministers and Consuls, [and] Judges of the supreme Court." U.S. CONST. art. II, § 2, cl. 2. The President also has the power to appoint "all other Officers of the United States," without advice and consent, although "Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments." *Id.*

The Framers' treatment of interstate agreements is comparatively terse: The Constitution lays down two rules, both written in prohibitory language: "No State shall enter into any Treaty, Alliance, or Confederation"; and "[n]o State shall, without the Consent of Congress, . . . enter into any Agreement or Compact with another State." U.S. CONST. art. I, § 10, cls. 1, 3. Moreover, although the Framers closely debated at the Constitutional Convention the provisions of that document understood to have significant moment, *see, e.g., Myers*, 272 U.S. at 110–15 (detailing the "very full" discussion of the presidential appointment power), there was no discussion whatsoever of the meaning of the Compact or State Treaty Clauses, *see* Weinfeld, *supra*, at 453–57. In the Federalist Papers, the only reference to the Compact and State Treaty Clauses is the offhand comment that the meaning of these provisions was "obvious." The Federalist No. 44 (Madison).

2. It is implausible that the Framers intended the Compact Clause as a means through which a group of states could circumvent the more specific provisions of the Constitution detailing the precise procedures for setting national policy, thereby allowing a plurality of States acting *qua* States to set national policy on their own. Not only would this be a departure from the origins and use of the Compact Clause for the last 200 years, *see supra* Part I.C, but also this would place too much weight on too meager a constitutional footing. It is not a rational drafting strategy to "hide elephants in mouseholes," *i.e.*, to "alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions." *Whitman v. Am. Trucking Ass'ns*, 531 U.S. 457, 468 (2001).

If anything, this principle is more true when it comes to the Constitution. While the document addressed some issues in broad terms, *see, e.g.*, U.S. CONST. amend. 5, it addressed the manner of making national policy with "finely wrought and exhaustively considered" structural provisions. *Chadha*, 462 U.S. at 951. That entire structural mechanism was designed to replace the failed state-centric approach of the Articles of Confederation. *See* The Federalist No. 15 (Hamilton) ("The great and radical vice in the construction of the existing Confederation is in

the principle of LEGISLATION for STATES or GOVERNMENTS, in their CORPORATE or COLLECTIVE CAPACITIES, and as contradistinguished from the INDIVIDUALS of which they consist.").

It is inconceivable that the Framers intended for Congress to be able to opt-in to a system of national law-making resembling the Articles of Confederation through a provision as uncontroversial and seemingly innocuous as the Compact Clause. Permitting a non-representative faction of States to formulate national policy affecting individuals and corporations outside those states — including the crucial policy of deciding which retailers are subject to taxation and which are exempt — would plainly undermine "the uniformity and the national character that the Framers envisioned and sought to ensure." *Thornton*, 514 U.S. at 822. "Such a patchwork would . . . sever the direct link that the Framers found so critical between the National Government and the people of the United States." *Id.*

The passage of the Seventeenth Amendment underscores the implausibility of viewing the Compact Clause as a means for States *qua* States to set national policy. The Seventeenth Amendment replaced the system of state-government appointment of Senators with democratic appointment of Senators, thereby eliminating the direct influence of State governments in the formation of national policy. *Compare* U.S. Const. amend 17, *with* U.S. Const. art. I, § 3, cl. 1. It would be peculiar indeed if, decades later, the Compact Clause were — for the first time — used to give to State governments even more direct control over the reins of national power than they had before the Amendment was enacted. The far better view is that the Compact Clause is a tool for resolving interstate disputes — as it was understood to be at the Founding and as it has been used ever since. The expansive national power of the SSUTA does not remotely fit this mold, and thus it would not be a valid interstate compact.

## II. THE MAIN STREET ACT WOULD VIOLATE THE APPOINTMENTS CLAUSE

Even if the SSUTA were a valid interstate compact, the Main Street Act would violate the Appointments Clause of Art. II, § 2. The Governing Board would exercise significant authority vis-à-vis national tax policy, including the uniquely federal power to lift Commerce Clause limits on state authority and to decide which retailers are exempt from taxation as "small sellers." But Board members are not appointed by "the President alone," "the Heads of Departments," or "the Courts of Law," as the Appointments Clause requires. *Buckley v. Valeo*, 424 U.S. 1, 126 (1976). Rather, the Board consists of state-appointed officials. SSUTA § 806.

### A. The Federal Executive or the Judiciary Must Appoint Officers Who Exercise Significant Federal Authority

The Appointments Clause provides that the President "shall have Power . . . by and with the Advice and Consent of the Senate, [to] appoint . . . Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law: but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments." U.S. CONST. art. II, § 2, cl. 2. On its face, the Appointments Clause "very clearly divides all its officers into two classes. The primary class of principal officers requires a nomination by the President and confirmation by the Senate," while the secondary class consists of "officers inferior to those specially mentioned," which Congress may "by law vest their appointment in the President alone, in the courts of law, or in the heads of departments." *United States v. Germaine*, 99 U.S. 508, 509–10 (1879); *accord Morrison v. Olson*, 487 U.S. 654, 670 (1988).

Although the Appointments Clause may not appear superficially important to modern eyes, it is one of the Constitution's core provisions enshrining the principle of the separation of powers. "The principle of separation of powers was not simply an abstract generalization in the minds of the Framers: it was woven into the document that they drafted in Philadelphia in the summer of 1787." *Buckley v. Valeo*, 424 U.S. 1, 124 (1976).

At the time of the Founding, legislative and executive misuse of the power to appoint (and remove) government officers was deemed "the most insidious and powerful weapon of eighteenth century despotism." GORDON S. WOOD, CREATION OF THE AMERICAN REPUBLIC 1776–1787, at 143 (1998); *see also* 1 WILLIAM BLACKSTONE, COMMENTARIES *324 (the Crown used its power to appoint and remove low-level functionaries to "exten[d] the influence of government to every corner of the nation"). By permitting Congress to delegate appointment power in only three enumerated ways, the Appointments Clause "reflects our Framers' conclusion that widely distributed appointment power subverts democratic government." *Freytag v. Comm'r*, 501 U.S. 868, 885 (1991).

The Supreme Court has noted that the Appointments Clause protects against Congress "aggrandizing its power" at the expense of the Executive. *E.g., Ryder v. United States*, 515 U.S. 177, 182 (1995). But that is not the Clause's only function. The Appointments Clause also "preserves another aspect of the Constitution's structural integrity by preventing the diffusion of the appointment power." *Freytag*, 501 U.S. at 878. The Appointments Clause is thus an express

check on Congress: It "prevents Congress from dispensing power too freely; it limits the universe of eligible recipients of the power to appoint." *Id.* at 880. Thus whether Congress is impermissibly aggrandizing its own power by delegating appointment power to itself, or whether Congress is impermissibly diffusing the appointment power by delegating it to other, non-enumerated recipients, the result is the same: The Clause is violated. *Cf. Loving v. United States*, 517 U.S. 748, 757 (1996) ("Even when a branch does not arrogate power to itself . . . , the separation-of-powers doctrine requires that a branch not impair another in the performance of its constitutional duties.").

"[A]ny appointee exercising significant authority pursuant to the laws of the United States is an 'Officer of the United States,' and must, therefore, be appointed in the manner prescribed" by the Clause. *Buckley*, 424 U.S. at 126; *Edmond v. United States*, 520 U.S. 651, 662 (1997). The Appointments Clause does not cover mere employees, *i.e.*, "lesser functionaries subordinate to officers of the United States." *Buckley*, 424 U.S. at 126 n.162. But appointees who "are not subject to the control or direction of any other executive, judicial, or legislative authority" are "inferior officers," not employees, and accordingly must be appointed under the Clause. *Id.* "Inferior officers" include a postmaster first class, *Myers*, 272 U.S. at 52, Tax Court "special trial judges," *Freytag*, 501 U.S. at 880–83, and Federal Trade Commissioners, *Buckley*, 424 U.S. at 126–27. The Supreme Court has never addressed whether an official implementing a federally-approved interstate compact is a federal "officer."

### B. The SSUTA Board Would Impermissibly Exercise Significant Authority Pursuant to Federal Law

1. SSUTA Board members are plainly not appointed in one of the Appointments Clause's three exclusive methods. Rather, the Governing Board comprises "members of the executive or legislative branches" of Member States. *See* SSUTA § 806. Thus, as long as SSUTA Board members exercise "significant authority pursuant to the laws of the United States," they are "Inferior Officers" and the Main Street Act violates the Appointments Clause.

In light of the Compact's purpose and design to effectuate tax policy on a national scale, there is little doubt that the Board would exercise "significant authority pursuant to" federal law. It is surely "significant" for the Board to decide which businesses are subject to the tax authority of remote Member States and which are exempt as "small sellers." Main Street Act § 7(a)(17). It is similarly "significant" for the Board to decide whether to admit or expel a State from SSUTA membership, and thereby to decide whether to lift *Quill*'s Commerce Clause restriction and to allow that State to tax remote sales. And if there is one thing that the Supreme Court's Commerce Clause jurisprudence makes clear, it is that the power to lift "dormant" Commerce Clause limits on the States' authority is a uniquely *federal* power.[8]

[8] Indeed, because this power is not only a uniquely federal power, but a federal power vis-à-vis the States, there is a serious question whether the power can be delegated to the States via the Compact Clause at all. In any event, if such a delegation were possible, it would only possible if it were done in a manner that complied with the Appointments Clause, and thus the Appointments Clause appears to be the narrower ground for purposes of constitutional analysis.

First, SSUTA Board Members cannot be deemed mere employees, *i.e.*, "lesser functionaries subordinate to officers of the United States." *Buckley*, 424 U.S. at 126 n.162. "[M]embers of the executive or legislative branches" of Member States are not ordinarily or inherently "subordinate" to any federal official, and neither the Main Street Act nor the SSUTA specifically places a federal official in a supervisory position with respect to the Governing Board.

Second, SSUTA Board Members would exercise authority "pursuant to" federal law. The Governing Board's authority to execute the SSUTA with respect to remote sales — the SSUTA's *raison d'être* — would derive from the Main Street Act. *See* Main Street Act § 4(a); *Quill*, 504 U.S. at 318. And both the Main Street Act and the SSUTA would be "law[s] of the United States." Congressional consent to a valid agreement "transforms" the States' agreement "into a law of the United States," and "construction of [that] agreement . . . presents a federal question." *Cuyler v. Adams*, 449 U.S. 433, 438 (1981); *see also Pennsylvania v. Wheeling & Bridge Co.*, 54 U.S. 518, 566 (1852) ("The compact, by the sanction of Congress, has become a law of the Union.").

To be sure, Board Members also would exercise authority pursuant to their respective State's laws. Absent state-law authority, no State could join the SSUTA or comply with its requirements, nor could any person become a Board Member: Board Members must be "members of the executive or legislative branches" of Member States. SSUTA § 806. State officials on the SSUTA Governing Board thus may be deemed to act pursuant to state law. *See Lake Country Estates, Inc. v. Tahoe Regional Planning Agency*, 440 U.S. 391 (1979).

But congressionally-approved interstate compacts are not creatures of state or federal law; they are hybrid legal entities jointly created by both federal and state authority. Compacts "typically are creations of three discrete sovereigns: two States and the Federal Government," and compact agencies thus "owe their existence to state and federal sovereigns acting cooperatively, and not to any one of the United States." *Hess*, 513 U.S. at 40, 42. It thus would be artificial to deem the SSUTA Governing Board as acting *either* pursuant to state *or* federal law. Rather, the Governing Board is properly understood to act pursuant to *both* state and federal law. *Cf. Munaf v. Geren*, 128 S. Ct. 2207, 2216–18 (2008) (military forces acting under joint federal and international authority act under color of federal law).

Third, the Governing Board has significant practical authority. Unlike decisions made by the Multistate Tax Commission or other non-compact interstate bodies formed by reciprocal legislation, *see Multistate Tax Comm'n*, 434 U.S. at 457, the decisions of the Governing Board cannot be deemed "advisory." Under the Main Street Act, the Governing Board has the power, *inter alia*, to define the "small seller exception" and to set the substantive rules States must follow to simplify their tax codes sufficiently. SSUTA § 903. Although Member States may choose not to modify their tax codes to comply with these definitions, *id.* at § 1102, a choice to breach the SSUTA carries serious legal penalties: The Governing Board may deem the State to be no longer "in compliance" with the SSUTA, thereby depriving the State of the power to tax out-of-state retailers. *Id.* at § 809(A); Main Street Act § 4(b)(2). A rule is binding, by definition, if its violation is met with a material sanction. *E.g.*, *United States v. Winstar Corp.*,

518 U.S. 839, 919 (1996) (Scalia, J., concurring in judgment) ("The duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it, — and nothing else." (quoting Oliver W. Holmes, Jr., *The Path of the Law* (1897), *in* 3 Collected Works of Justice Holmes 391, 394 (1995))).

2. Quite uniquely for an agreement that purports to be a "compact," SSUTA Board Members would have the power to set rules and policies that would have significant economic effects not only within the borders of the compacting States, but also beyond. The whole purpose of the Main Street Act and the SSUTA is to permit Member States to require tax collection and remittance from out-of-state retailers whose only contact with the Member State is pursuant to a remote sale. State officials nominated by a minority of States thus would have the power, under the SSUTA, to set tax policy with nationwide effect over the millions of retailers that make mail-order or internet sales to customers in other States.

To be sure, state-appointed officials implement some congressionally-approved interstate compacts. *E.g., Hess v. Port Authority Trans-Hudson Corp.*, 513 U.S. 30 (1994); *Metropolitan Washington Airports Authority v. Citizens for the Abatement of Aircraft Noise, Inc.*, 501 U.S. 252 (1991); *West Virginia ex rel. Dyer v. Sims*, 341 U.S. 22 (1951). As set forth *supra* Part I.B, this modern innovation is not easily squared with the original understanding of the Compact Clause. But even assuming that this practice does not render the SSUTA an unconstitutional state treaty, the Main Street Act still would violate the Appointments Clause.

Under *Buckley*, the question is not *whether* a state-appointed official implementing a federally-approved interstate compact exercises authority pursuant to federal law — all such officials would — but *to what extent* does the official exercise federally-derived authority. *Buckley*, 424 U.S. at 126. Accordingly, when state-appointed officials implement a reciprocal agreement that does not "propose to authorize the member States to exercise any powers they could not exercise in its absence," then there is no Appointments Clause problem: The officials who implement these agreements exercise little or no federally-derived authority. *Multistate Tax Comm'n*, 434 U.S. at 473.

State-appointed officials who implement compacts, such as the New York-New Jersey Port Authority, present a closer question. Federal approval is necessary for New York and New Jersey to regulate jointly their shared natural harbor. *See* Frankfurter & Landis, *supra*, at 707 ("The mechanism of legislation must . . . be greater than that at the disposal of a single State."). Although congressional authorization is needed to form such compacts, those officials do not wield significant federal power on an ongoing basis. Rather, the States merely exercise their own powers to regulate commerce.[9] Moreover, in such compacts, the direct impact of any federal authority is limited to compacting States, which have consented to this intrusion.

3. The federal character of the SSUTA is different in degree and in kind. First, the Main Street Act would authorize SSUTA Member States to regulate interstate commerce by imposing

[9] Similarly, when state officials implement federal statutory regimes, they do so only within their own state's borders. *E.g.*, 42 U.S.C. § 7410(a)(1) (granting State officials authority for "implementation, maintenance, and enforcement" of federally-defined emissions standards under the Clean Air Act).

tax burdens on out-of-state retailers that direct sales at in-state customers — thereby directly impacting the activities of private parties in *non-compacting* states. Main Street Act § 4(a). Furthermore, acting pursuant to the Main Street Act, Board Members also would have the substantial ongoing powers to "interpre[t]" the SSUTA and any definitions the Board issues, to "promulgate rules" for a dispute-resolution process, to "take any action that is necessary and proper to fulfill the purposes of the Agreement," or even to amend the SSUTA itself. SSUTA §§ 806, 901, 902, 1001.

Most significantly, the Board would be empowered to decide which sellers to subject to the taxation authority of remote Members States and which retailers to exempt as "small sellers." Main Street Act § 7(a)(17). This is an extraordinary power with tremendous impact on millions of small businesses. It is estimated that, even back in 2004, there were more than 5 million small-volume sellers online — "retailers and individual sellers [that] are too small to measure activities at a unique web site" and that instead sell via eBay.com and other platforms. Joe Bailey et al., *The Long Tail Is Longer Than You Think*, Robert H. Smith School of Business Working Paper at 5, 7 (May 12, 2008).

The Board's power to decide which retailers to tax and which to exempt is a matter of substantial national importance. Indeed, the notion that a group of state officials could set tax policy impacting so many individuals and small businesses in other States runs afoul of the core principle that there should not be taxation without representation — a principle that was central to the formation of the United States. We are aware of no federal statute or interstate compact that has granted state officials ongoing federal power that was remotely this significant.

4. In addition to having extensive and ongoing power over the national economy and millions of individuals and small businesses, the Board would wield the uniquely *federal* power of deciding whether to permit other States to regulate interstate commerce. The Board derives this power from the confluence of its control of membership in the SSUTA — the Board can admit or expel a State from the Compact — with the fact that the Main Street Act ties congressional authorization to tax out-of-state retailers to SSUTA membership. *Id.* at §§ 804, 809(A), 903; Main Street Act § 4(a)(1). The Governing Board thus has the ongoing ability to decide which States the federal government will authorize under the Commerce Clause to tax foreign retail sales. Congress may be able to authorize state officials on interstate compact agencies to regulate interstate commerce to some extent, but it is quite another thing for Congress to hand to state officials the keys to the Commerce Clause itself.

## III. STATE TAXATION OF REMOTE SALES UNDER THE MAIN STREET ACT WOULD OFTEN VIOLATE THE DUE PROCESS CLAUSE

Although Congress "may authorize state actions that burden interstate commerce," it "does not similarly have the power to authorize violations of the Due Process Clause." *Quill*, 504 U.S. at 305. Due Process in turn "demands that there exist some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax, as well as a rational relationship between the tax and the values connected with the taxing State." *MeadWestvaco*, 128 S. Ct. at 1505 (internal quotation marks omitted). A use tax is inherently related to a sale made to an in-state customer, *see Quill*, 504 U.S. at 308, and thus Due Process's key requirement in this area is that an out-of-state retailer have sufficient minimum contacts with the taxing state. The Main Street Act will allow Member States to tax out-of-state retailers that lack sufficient minimum contacts, and thus the Main Street Act will lead to many Due Process violations.

### A. Due Process Forbids a State from Exercising Jurisdiction Over a Party with whom the State Lacks Sufficient Minimum Contacts.

In *Quill*, the Supreme Court analyzed the Due Process limitations on state taxation of a sale made by an out-of-state mail-order retailer to an in-state customer. In assessing whether the remote seller had sufficient minimum contacts with the taxing jurisdiction, the Supreme Court abandoned the physical-presence requirement from *Bellas Hess*, and instead applied the framework from *International Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945). *See Quill*, 504 U.S. at 307. *International Shoe* eschews bright-line rules, instead mandating a "flexible inquiry into whether a defendant's contacts with the forum" are sufficiently strong that a state's exercise of jurisdiction based on those contacts comports with "traditional notions of fair play and substantial justice." *Id.* (quoting *Int'l Shoe*, 326 U.S. at 316); *see also id.* (a state's exercise of jurisdiction must be "reasonable, in the context of our federal system of Government").

"[T]raditional notions of fair play and substantial justice" prohibit a state from exercising its jurisdiction upon an out-of-state party unless the party first "purposefully avails itself of the benefits of an economic market in the forum State," thereby "invoking the benefits and protections of its laws." *Id.*; *Hanson v. Denckla*, 357 U.S. 235, 253 (1958). "[R]andom, isolated, or fortuitous" contacts are insufficient. *Keeton v. Hustler Magazine, Inc.*, 465 U.S. 770, 774 (1984).

It is not the raw quantity of contacts that matters, but their quality. A single act may give rise to jurisdiction if it creates a "substantial connection" with the forum. *See McGee v. Int'l Life Ins. Co.*, 355 U.S. 220, 222 (1957) (an ongoing life insurance contract). But repeated acts will not give rise to jurisdiction if the "nature and quality and the circumstances of their commission create only an attenuated affiliation with the forum." *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 475 n.18 (1985) (internal quotation marks omitted). The inquiry is thus highly fact-specific, "rather fuzzy," and "fairly unpredictable." 1 LAWRENCE TRIBE, AMERICAN CONSTITUTIONAL LAW 1282–83 (3d ed. 2000).

One principle that is clear, however, is that the mere formation of a contract with the resident of another state is an insufficient basis for that state to assert jurisdiction. *Burger King Corp.*, 471 U.S. at 478. Jurisdiction is proper only over "parties who reach out beyond one state and create continuing relationships and obligations with citizens of another state." *Id.* at 473. Thus "prior negotiations and contemplated future consequences, along with the terms of the contract and the parties' actual course of dealing . . . must be evaluated in determining whether the [party] purposefully established minimum contacts within the forum." *Id.* at 479.

Applying these principles to the large mail-order retailer in *Quill* was straightforward. The Supreme Court concluded that there was "no question" that North Dakota's assertion of tax jurisdiction was consistent with Due Process. 504 U.S. at 308. The retailer "purposefully directed its activities at [in-state] residents" by "engag[ing] in continuous and widespread solicitation of business" within North Dakota. *Id.* at 302, 308. Moreover, the "the magnitude of those contacts [was] more than sufficient," as Quill completed "almost $1 million" in annual sales "to about 3,000 customers" in the state, making Quill the sixth largest vendor of office supplies in North Dakota. *Id.*

### B. The Main Street Act Authorizes Member States to Tax Remote Sales Even When the State Lacks Sufficient Minimum Contacts with the Seller

1. Few businesses will have contacts with remote states that are as extensive as Quill's contacts with North Dakota. For many smaller or more locally-focused businesses, contacts with distant states will be isolated or attenuated. Taxation by those states would violate Due Process.

The Main Street Act recognizes this problem and carves out a "small seller exception" to a Member State's authority to demand that remote sellers collect and remit use taxes. *See* Main Street Act § 4(a)(1). But this is only a partial fix. The Main Street Act does not define "small seller," and instead delegates to the SSUTA Board the power to do so. *Id.* at §7(a)(17). The SSUTA Board has not yet issued such a rule. It has signaled, however, that the rule will be "based on national remote sales volume," not sales volume to a particular state, and that the triggering amount of sales will be low. SSUTA § 610. The Board is currently considering setting the initial threshold at $500,000 with a plan to ratchet it down to $100,000 within four years. Kansas Proposal at 1–2.

By removing the very smallest businesses from the ambit of a Member State's remote taxation authority, the Main Street Act reduces the likelihood of taxation where a local seller makes a random or isolated sale to a distant state. The "small seller exception" is very small indeed, and will not, in all events, cure the Due Process problem.

2. Under the SSUTA, the categorization of a seller as "small" will depend upon its gross remote sales "nationwide." *Id.* But gross remote sales do not satisfy the Due Process Clause as to all 50 states. The Due Process Clause does not demand minimum contacts with other states in gross. Rather, to satisfy Due Process, the seller must have sufficient minimum contacts *with each taxing state*. *See World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 293 (1980)

(the Supreme Court could not "accep[t] the proposition that state lines are irrelevant for jurisdictional purposes" while "remain[ing] faithful to the principles of interstate federalism embodied in the Constitution"). The Main Street Act will thus authorize numerous instances of unconstitutional taxation.

The core problem is that a business may make enough remote sales "nationwide" to cross the "small seller" threshold, while only "purposefully availing" itself of the benefits of the markets in a few states. This will be particularly common for businesses that target a market in a region of the country or in a metropolitan area, such as New York City or Philadelphia, which spans multiple states' lines. Under the Main Street Act, any SSUTA Member State would be authorized to tax a remote sale by such a business — even if the business did not purposefully direct its business activities at that state.

For example, if a Missouri business directed its business activities at the Kansas City metropolitan area, thereby making enough Kansas sales to surpass the gross nationwide sales threshold, it would not constitute a "small seller" under the Main Street Act. *Id.* at § 4(d). If that business made only a single over-the-counter sale to a Rhode Island resident who wanted the article to be shipped to his home, the Main Street Act would authorize Rhode Island to tax the sale. *See* SSUTA § 310(A)(2) (if a "product is not received by the purchaser at a business location of the seller," but instead is delivered to another state, then the receiving state may tax the transaction). This would be true even if the Missouri business conducted no activity in Rhode Island, never solicited business in Rhode Island, and had never previously shipped an item to Rhode Island.

Such isolated and incidental contact with a state clearly does not constitute "purposeful availment" of the "benefits of [that state's] economic market" or the "protection of its laws." *Quill*, 504 U.S. at 307; *Hanson*, 357 U.S. at 253. Certainly, the retailer's purposeful availment of customers in Kansas does nothing to establish minimum contacts with Rhode Island. And the one-time sale of a good to an Rhode Islander does not "create continuing relationships and obligations with citizens of [that] state." *Burger King Corp.*, 471 U.S. at 471. Rather, such contact is incidental and fleeting; the sale involves the remote state "only because that is where the purchaser happened to reside." *Boschetto v. Hansing*, 539 F.3d 1011, 1019 (9th Cir. 2008). Such tenuous contact is plainly insufficient. *Id.* at 1017, 1019; *Keeton*, 465 U.S. at 774 ("random, isolated, or fortuitous" contacts are insufficient); *see also, e.g., Charia v. Cigarette Racing Team, Inc.*, 583 F.2d 184 (5th Cir. 1978) (insufficient contacts for Louisiana to assert jurisdiction over a Florida seller that sold a boat to a Louisiana purchaser and shipped the boat F.O.B. to Louisiana).[10]

[10] *Quill* itself shows that an out-of-state retailer's mere delivery of an item to another state does not give rise to sufficient minimum contacts. If delivery were sufficient, Quill's status as a mail-order retailer would have been dispositive. The Supreme Court's opinion, however, did not leave it at that. Instead, the Court found sufficient contacts based on Quill's "continuous and widespread solicitation of business" within North Dakota and the magnitude of Quill's sales to that State. *See* 504 U.S. at 308.

3. The Main Street Act would also lead to unconstitutional taxation of online sales. In order to make a sale to another state, a mail-order retailer such as Quill must first solicit business in that state by purposefully sending catalogs to potential customers there. E-commerce, by contrast, does not inherently involve such purposeful availment. A "website is not directed at customers in the [a state], but instead is available to all customers throughout the country who have access to the Internet." *Trintec Indus., Inc. v. Pedre Promotional Prods., Inc.*, 395 F.3d 1275, 1282 (Fed. Cir. 2005). Thus 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.

The lack of contact between the remote seller and the taxing state is starkest when an item is placed for sale on a third-party marketplace website, such as the eBay.com marketplace platform. For example, if a medium-sized construction business opted to sell a single piece of used construction equipment on eBay.com, the Main Street Act would require the business to collect and remit a tax to the state of the purchaser — no matter where in the country the purchaser happened to be. *See* SSUTA § 301(A)(2).

Merely placing an item for sale on eBay.com does not constitute "purposeful availment" of the benefits and protections of the purchasing state's laws. Numerous courts have addressed personal jurisdiction in suits arising from eBay.com sales, unanimously holding that such isolated or sporadic sales on eBay.com are insufficient. *See, e.g., Boschetto*, 539 F.3d at 1019 & n.6 ("use of eBay as a conduit" for a "one-time transaction" does not give rise to jurisdiction); *Metcalf v. Lawson*, 148 N.H. 35, 40–41 802 A.2d 1221, 1227 (2002) (isolated eBay sales insufficient); *Winfield Collection, Ltd. v. McCauley*, 105 F. Supp. 2d 746 (E.D. Mich. 2000) (same).[11] Quite simply, it is unconstitutional to force an out-of-state seller to collect and remit a tax based on an isolated online sale.

Even when a seller operates its own website, the Main Street Act could still lead to unconstitutional taxation. A medium-sized brick-and-click business — *i.e.*, a business with a brick-and-mortar location that also operates an e-commerce website — could use its website to target a cross-border market in a particular region, thereby crossing the "small seller" threshold, while only making "isolated" and "fortuitous" sales to customers in distant states. Notwithstanding the lack of purposeful contact between the seller and the state, the Main Street Act would authorize taxation.

To be sure, a seller must act purposefully to maintain an e-commerce website. And some courts have held that the mere maintenance of an "interactive" website constitutes "purposeful availment" in all 50 states. *See Zippo Mfg. Co. v. Zippo Dot Com*, 952 F. Supp. 1119 (W.D.Pa. 1997). But whether a website is "interactive" is "not necessarily reflective of the intent and

[11] Courts have found jurisdiction to be proper when the party makes eBay sales regularly or continually. *See, e.g., Dudnikov v. Chalk & Vermilion Fine Arts, Inc.*, 514 F.3d 1063 (10th Cir. 2008) (thousands of eBay sales); *Dedvukaj v. Maloney*, 447 F.Supp.2d 813, 822–23 (E.D. Mich. 2006) ("regular and systematic" eBay sales); *Crummey v. Morgan*, 965 So.2d 497, 500 (La. App. 2007) (repeated eBay sales to the particular remote jurisdiction).

desires of the content provider," it is a "mere technical question of programming." Holger P. Hestermeyer, *Personal Jurisdiction for Internet Torts*, 26 NW. J. INT'L L. & BUS. 267, 278 (2006).

When *Zippo* was decided in 1997, online retailers needed to hand code their own e-commerce capability — with each website custom writing the software to manage a shopping cart, process credit cards, track orders, track shipping, and the like. This process took considerable technical expertise and effort, and thus as late as 1999, the approximate average cost to build an e-commerce website was $1,000,000. *See* David Leggard, *Average Cost to Build E-Commerce Site: $1 Million*, THE INDUSTRY STANDARD, May 31, 1999, at 1. Thus in 1997, it was perhaps fair to assume that a business with an interactive website consciously sought to take advantage of the market nationwide.

Technological innovations have made this assumption obsolete. Rather than hand-coding e-commerce functionality, a business can now add a third-party "snap-in" e-commerce platform to a website for a small fraction of its 1999 cost. *See, e.g.*, Yahoo! Small Business (selling basic e-commerce capability for $39.95 per month). As a result, if an established local brick-and-mortar business adopts an online presence, intending to allow its local customers to make purchases online, that business will incidentally gain the ability to sell nationwide.

Thus, as the Third Circuit has recognized, "mere operation of a commercially interactive web site" does not show "that the [operator] 'purposefully availed' itself of conducting activity in the forum state." *Toys "R" Us, Inc. v. Step Two, S.A.*, 318 F.3d 446, 454 (3d Cir. 2003).[12] Rather, the critical question is whether the business "directly target[ed] its web site to the state, knowingly interacting with the residents of the forum state via its web site, or through sufficient other related contacts." *Id.*; *see also ALS Scan v. Digital Svc. Consultants, Inc.*, 293 F.3d 707, 714 (4th Cir. 2002) (a website must "manifes[t]" the seller's "intent of engaging in business or other interactions within the [forum] State"). A brick-and-click business that services a local market will not "directly target" the market in a distant state. If such a distant state sought to tax an isolated or fortuitous purchase from that retailer, therefore, it would violate Due Process.

In sum, although the Main Street Act's "small seller exception" mitigates Due Process problems, it does not eliminate them. Rather, the Main Street Act will authorize SSUTA Member States to tax remote sellers that are too large to be "small" businesses, even if the seller has only isolated, attenuated, or unintentional contacts with the taxing state.

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[12] Because *Zippo* was issued by a District Court within the Third Circuit, *Zippo* appears to have been overtaken not only by subsequent technological developments, but also by subsequent legal developments.

# Conclusion

If enacted, the Main Street Act would (1) violate the State Treaty Clause because the SSUTA is not a valid interstate compact; (2) violate the Appointments Clause by granting to States the power to appoint Inferior Officers of the United States; and (3) lead to violation of the Due Process Clause by authorizing SSUTA Member States to force out-of-state sellers to collect and remit taxes, even when those sellers lack sufficient minimum contacts with the taxing state.

Mr. SMITH. Thank you, Mr. Lungren.

The gentleman from Michigan, the Ranking Member of the Judiciary Committee, Mr. Conyers, is recognized for an opening statement.

Mr. CONYERS. Thank you, Chairman Smith, and Members of the Committee and the distinguished witnesses here.

I want to associate myself with the Chairman's opening statement and description of why we are here this morning and I am glad that he mentioned my bill.

The only thing I regretted was that he is not a co-sponsor of it yet. So we will see how this hearing proceeds and whether we can enjoy the benefit of his support.

Now, we all know about the *Quill* decision. But since the *Quill* decision there has been a tremendous growth in online commerce.

The number and diversity of goods purchased from large online retailers with little physical presence in the buyer's state has dramatically increased. What is it, up to 36 percent now, 38 percent over the weekend—38 percent is now online.

The result, of course, is that online retailers have, let's face it, an unfair advantage over local and small businesses who are required to collect sales taxes and so what we are doing today is exploring the need for legislation to level the playing field between small businesses and online retailers. Main Street retailers, local mom-and-pop stores in many instances, and even some of the big-box retailers suffer when they have to collect a sales tax but online retailers don't, and fewer purchases at local retailers means less local jobs.

And I might suggest to you that that 38 percent retail number is going up. The number of people purchasing over the Internet is going up and it is at 38 percent already. Lower sales at local retailers means lower revenue for local and state governments as sales taxes constitute a significant revenue source in each and every state.

With ever increasing online sales, the state and local governments anticipate larger and larger revenue losses as a result of uncollected sales and use taxes. Michigan, my state, for example, estimates that it has lost around $368 million each fiscal year and that it will lose more than $450 million in the fiscal year 2013.

The impact of such lost revenue is reflected in reduced school programs, extracurricular activities at the public—in the public school systems across the state, bridges and roads in need of critical repairs are neglected and reduced services even for police and firefighter protection sometimes occurs.

And so H.R. 2701, the Main Street Fairness Act, would grant the consent of Congress to the Streamlined Sales and Use Tax agreement drafted by local and state governments and then business community to simplify sales tax rules and administrative requirements, making it easier for businesses to collect sales taxes across state lines.

Already, 24 states have changed their laws to comply with this agreement and I await your consideration of your—the great witnesses we have, Mr. Chairman, and we urge that we consider the relative merits of all the bills that are before this Committee and I thank you.

Mr. SMITH. Thank you, Mr. Conyers.

I would also like to recognize Congressman Steve Womack sitting in the front row over here. He is the author of the Marketplace Equity Act. We appreciate your introducing that, Steve. Thank you.

We will now go to the introduction of our witnesses and actually the Ranking Member, Mr. Conyers, will introduce going from left to right, our first witness.

Mr. CONYERS. Thank you.

I am happy to introduce our first witness at this hearing because he is a small-business owner from Lansing, Michigan, Dan Marshall, the second-generation operator of a family-owned chain of music stores called Marshall Music with seven stores located throughout Michigan.

As a failed musician himself, I should visit you as often as I can when we have the time in this busy Congress.

But his parents founded the store in 1948 and it has grown and is doing well and he has got now 300 full-time and part-time employees, music instruments and offers performance space and lessons to shoppers and musicians. I am doing quite a bit of advertising for you today, sir. [Laughter.]

But I am glad that you are here to tell your story on behalf of many of the small-business owners in the country.

Thank you, Mr. Chairman.

Mr. SMITH. Thank you, Mr. Conyers.

Our next witness is Dr. Patrick Byrne. Dr. Byrne is the chairman and CEO of Overstock.com, a Utah-based Internet retailer that has been publicly traded since 2002. Like many so-called e-tailers, Overstock takes orders over the Internet from customers and relies on common carriers to deliver purchased merchandise.

In 2010, Overstock reported approximately $1.2 billion in revenue. Dr. Byrne received a Bachelor's degree in philosophy and Asian studies from Dartmouth College, a Master's in philosophy from Cambridge University as a Marshall Scholar and a doctorate in philosophy from Stanford University.

He has taught at the university level and frequently guest lectures on business, the Internet, leadership and ethics.

Our next witness will be introduced by the gentleman from Indiana, Mr. Pence.

Voice. From Texas, Mr. Poe.

Mr. SMITH. Oh, I am sorry. Jumping ahead. The next witness will be introduced by the gentleman from Texas, Mr. Poe.

Mr. POE. Thank you, Mr. Chairman.

Our next witness is my friend, John Otto, who is my state representative in Texas. He was elected to the House of Representatives in 2004. He is from small-town America, Dayton, Texas.

Mr. Chairman, you may not know this but this is important. Dayton, Texas has a population of about 5,000. They have a high school football stadium that seats 7,000 and it is always full on Friday night.

But by trade John Otto is a CPA. He has served on the Texas House Appropriations Committee and he serves as Vice-Chairman of the House Committee on Ways and Means. In 2008, he was chosen to Chair the House Select Committee on property tax relief and appraisal reform.

In 2005, he was named the Republican Freshman of the Year in the Texas House of Representatives and Texas Monthly has named him one of the ten best legislators in Texas.

He is a graduate of Texas A & M and a BBA from that university.

John, in your Honor I have worn orange today to celebrate last week's Thanksgiving Day game. [Laughter.]

Where Texas won.

I yield back, Mr. Chairman. Thank you. [Laughter.]

Mr. SMITH. Thank you, Mr. Poe.

Our next witness is Tod Cohen. Mr. Cohen is the vice president of government relations for eBay. Since 2000, Mr. Cohen has been responsible for global public policy for eBay including adding PayPal when it was acquired in 2002. 2006 he became responsible for eBay's legal, regulatory and intellectual property work as well as law enforcement affairs and global investigation teams.

Mr. Cohen received his B.A. from the University of Utah in 1985 and his J.D. with highest honors from the George Washington University Law School in 1992. Before law school, Mr. Cohen worked as a congressional aide for 4 years.

Founded in 1995, eBay's website facilitates private transactions between private buyers and sellers. It currently boasts about 100 million users worldwide. Many are small business owners who maintain a virtual storefront on the eBay platform. 2010, the total value of goods sold on eBay was $62 billion, which is more than $2,000 every second.

The next witness will be introduced by the gentleman from Indiana, Mr. Pence.

Mr. PENCE. Thank you, Chairman. Thanks for the courtesy of having a chance to introduce and welcome my friend and a fellow Hoosier to testify before the Judiciary Committee today in what, after a long and distinguished career of public service in Indiana, I am pleased to say is his first opportunity to testify before Congress and I am privileged to be here.

Senator Luke Kenley is from Noblesville, Indiana. He is a five-term Indiana state senator.

He has provided exceptional leadership on fiscal responsibility and pro-growth policies in Indiana throughout his career.

He is Chairman of the Senate Committee on Appropriations at the State House in Indianapolis and I hasten to add, since we are doing a little bit of trash talk between states, Indiana has found a way even in these difficult economic times to balance our budgets without raising taxes and Senator Kenley has been a driving force in making Indiana the fiscal envy of the Nation.

His career spans several decades, involves several different disciplines. After completing his undergraduate degree at Miami University of Ohio and 2 years of law school at Harvard University, he answered the call of his country, enrolled in Officer Candidate School for the U.S. Army, graduated first in his class, served as an Army lieutenant, returned to Harvard to complete his law degree and then returned to the Hoosier State to develop and operate Kenley Supermarkets and serve as Nobleville's city judge.

Senator Kenley comes before us today though on behalf of the Streamlined Sales Tax Governing Board in his capacity as presi-

dent of that organization. The Streamlined Sales Tax Governing Board has been a leading advocate for fair and effective collection of online sales taxes.

I am confident that his experience in this area and his testimony today will be of great benefit to the Committee as we work toward an equitable and common sense solution for all parties concerned.

So thank you, Mr. Chairman, for the courtesy of allowing me to introduce this esteemed fellow Hoosier, Senator Luke Kenley, to the Committee's hearing today and I yield back.

Mr. SMITH. Thank you, Mr. Pence.

Our final witness is Paul Misener. Mr. Misener is the vice president of worldwide public policy for Amazon.com where he has worked for over a decade. He holds an engineering degree from Princeton and earned his law degree from George Mason.

At Amazon, he is responsible for formulating and representing the company's public policy positions worldwide as well as for managing policy specialists in Asia, Europe and North America.

Jeff Bezos founded Amazon in 1995. According to Amazon's website, during the first 30 days of business Amazon.com fulfilled orders for customers in 50 states and 45 countries, all shipped from Mr. Bezos' home garage near Seattle.

Today, Amazon is one of the largest e-tailers. It offers customers the ability to purchase everything from books to electronics and now even prepared gourmet foods over the Internet.

We appreciate the witnesses who are here today and Mr. Marshall, we will begin with you.

**TESTIMONY OF DAN MARSHALL, MARSHALL MUSIC COMPANY, ON BEHALF OF HIMSELF AND THE MICHIGAN RETAILERS ASSOCIATION**

Mr. MARSHALL. Good morning, Chairman Smith and——

Mr. SMITH. Make sure your mike is on there. If you will——

Mr. MARSHALL. I am sorry?

Mr. SMITH. Is your mike on? Push the—there. There we go.

Mr. MARSHALL. Thank you.

Good morning, Chairman Smith, Ranking Member Congress—Conyers and Members of the Committee.

My name is Dan Marshall. I represent Marshall Music Company, a Michigan-based chain of retail music stores and I am also here to speak on behalf of the Michigan Retailers Association, an association of small-business entities totaling roughly 4,800 individual businesses, and I am here to speak on behalf of small-business Main Street retailers in connection with what we see as an unlevel playing field relating to all of us as retailers being required to collect sales tax and having customers every day, every hour that we operate coming in and price shopping and comparing our price with Internet retailers that do not collect the Michigan sales tax.

Marshall Music was started in 1948 by my mother and father, Bill and Mary Marshall. I am the second-generation family leadership of the business. We have seven locations throughout the state of Michigan.

We provide sales and service for musical instruments and accessories, repair, lessons and, indeed, call on music educators through-

out the state of Michigan and rent and sell band and orchestra instruments to beginning music participants.

I can't begin to tell you what challenges retailing in a state like Michigan have presented to Marshall Music but myself and other Main Street retailers have adjusted to the economic realities that a fiercely competitive environment present and we are perfectly comfortable with that.

In the absence of competition, I suppose we would all become complacent. That is certainly not the case with Marshall Music and my fellow retailers.

The size of small business I think is something that somehow gets lost in the shuffle sometimes. Michigan retailers of 4,800 individual members, a casual measurement, you know, roughly 70 percent of those members are doing less than $300,000 a year in business.

You know, in many cases it is a husband and a wife, maybe a part-time employee. So, you know, Main Street retailing is not a big numbers game but, you know, every strip mall and shopping center and downtown shopping district is replete with retailers just like my family who every day employ, you know, significant numbers of people for services and support.

Illustrative of that would be today in Michigan we got eight inches of snow overnight so there is snow removal, small-business snow removal companies removing snow from all of our parking lots and, you know, helping us get our doors open for business today.

We have been selling on the Internet through eBay for some time now and Internet retailing is just a wonderful opportunity for small-business people.

You know, it allows us not necessarily to sell everything that we have in inventory, you know, and in many cases we are just not prepared or capable of providing the support and fulfillment and having the computer systems to effectively represent our entire product mix on the Internet.

But in virtually every instance there are some products or some area of expertise, whether it is oddball, obsolete or used merchandise that—to promote that, you know, on the World Wide Web to a much larger market is very beneficial.

In our case, that is exactly what we do. A product that we have had in inventory too long or is used or unique we will put in on the Internet and find a buyer in a larger market than our area markets.

I understand and accept that, you know, we have to be competitive and we are. We price match every day. We price our products, you know, according to what the marketplace dictates.

But to have that additional 6 percent sales tax differential is something that just creates an unlevel playing field and doesn't really make sense to me or other retailers why a Michigan resident has to pay sales tax if they buy from a local merchant or buy from an Internet site that has a presence in Michigan whereas if they do business with somebody that is not employing people or supporting the Michigan economy they don't have to—that retailer doesn't have to collect sales tax.

As far as requiring us to collect sales tax from out-of-state sales, I see that as an entirely doable endeavor. You know, clearly, capitalism—people, you know, if they perceive a need people are going to flock to fill that need and the resources that are available today make the collection of that sales tax possible and I am sure it will only get easier and more streamlined if, in fact, you provide states like Michigan enabling legislation to allow us to have all Internet retailers collect tax.

[The prepared statement of Mr. Marshall follows:]




Testimony of Dan Marshall of Marshall Music

before the

House Judiciary Committee

Constitutional Limitations on States' Authority
to Collect Sales Tax in E-Commerce

November 30, 2011

Good morning Chairman Smith, Ranking Member Conyers, and members of the Committee. My name is Dan Marshall, a small business owner from Lansing, Michigan, and I appreciate this opportunity to testify before the Committee this morning on leveling the playing field for Main Street. I am testifying today on behalf of the Michigan Retailers Association and the millions of Main Street merchants throughout the U.S.

I am the 2nd generation operator of a family-owned chain of music stores called Marshall Music, with seven bricks-and-mortar stores located throughout Michigan. My mother and father founded Marshall Music in 1948 and over the last 63 years the company has grown into the mid-west's largest retailer of band and orchestra instruments. We are an integral part of the community providing jobs, job training, paying property taxes, and even providing a service to the state by collecting and remitting sales taxes. Without businesses like mine, there would be no Main Street.

We proudly employ 300 full time and part time employees, down approximately 10 percent from our peak a few years ago. Sales volume has been as high as $24 million and last year we did around $18.5 million in sales through our seven store fronts, and around 5 years ago we started selling some items online through eBay averaging $125,000 annually.

For the last 63 years, Marshall Music has operated across the state serving musicians, schools, students, teachers, enthusiasts and more. We sell music instruments, equipment, and offer performance space and lessons to shoppers and musicians. We pride ourselves on customer service and having knowledgeable associates who can help match shoppers with the right products.

I do not have to tell you that retail is a fiercely competitive industry. As we are now in one of the busiest shopping seasons of the year, we are – **and must** – stay price competitive with the guys not just down the street, but also our competitors online. But that competition is no longer on a level playing field, and the business my mother and father started is facing an unprecedented attack they never could have envisioned 60 years ago.

Today, bricks-and-mortar stores like ours are becoming the showrooms for online-only companies like Overstock, Amazon and eBay. Customers literally come into our stores every single day to play, touch, look at, and evaluate higher-end musical equipment, only to walk out of the store and go home to purchase the item from an online retailer that does not collect the state sales tax at the point of purchase.

Retailers have always had the ability to match prices. For the professional music equipment Marshall Music sells, our customers are very sophisticated on price. Our sales associates are fully aware of online prices and we are able to match those prices for customers. Matching or beating the price of a competitor – regardless of whether it is a bricks-and-mortar store or an online shop – is part of retail. Always has been and always will be. But what I cannot do is tell the customer that I do not have to charge them the state sales tax. In fact, if I did that, I'd find myself audited, fined and potentially thrown in jail.

And for those customers that are convinced they are getting a special deal when the sales tax is not collected by an online retailer, most are completely unaware that they still owe the state sales tax on that item regardless of whether they purchased the item in my store or online. But when I collect it at the register I do a service for the both the state and the customer, relieving

the latter of the burden of collecting receipts and calculating their sales tax – something they are legally required (but rarely do) for online purchases.

A recent national survey found that three-quarters of consumers were not even aware they had this obligation when filing state tax returns. This same survey found that sixty-one percent of consumers, when informed of their obligations, support Congress passing legislation that would allow states to require online-only retailers to collect state sales tax just like storefronts in the community.

Back home in Michigan we have a state sales tax of 6 percent that is tacked onto every purchase. These are funds that states use to keep our schools running and to make sure our communities stay safe. As a small business owner I would be happy if there was not a sales tax in the state, but I know that is not necessarily practical. But if we are going to pay for essential services with a sales tax, I want everybody to play by the same rules. Regardless of whether a sale occurs in a store or online, the sales tax should be the same. In a free market, government should not be giving one type of business an advantage over everyone else.

Make no mistake; I am not afraid of online competition. As I mentioned earlier in my testimony, I do sell a small number of items through eBay, and I welcome the technological advances that have enabled me to do that. But at the same time, the internet is no longer in its infancy, and it makes little sense to continue to give online sellers special treatment in the tax code to the detriment of everyone else. In fact, I would gladly collect sales taxes for the out-of-state sales I make on eBay if it meant a level playing field for everyone. The reality is that software exists today to make the calculation quite simple – it is no longer the burden it was 20 years ago, and giant online retailers like Overstock, Amazon and eBay know it.

The bottom line is that a sale, is a sale, is a sale, regardless of how the item was purchased.

To be clear, fixing this problem is **not** imposing a new tax on anyone. Forcing an online-only retailer to collect owed sales taxes is not a new tax on that online business: it is simply having them play by the same rules as bricks-and-mortar businesses who already collect on behalf of their customers.

In the past decade, this is a problem that has manifested into a direct threat to jobs on Main Street. Online commerce has been growing at a rate of over 10 percent annually, and it will only continue to sharply rise. We simply cannot compete when the government gives an unfair advantage to one segment of the retail community. Stores will continue to close down and jobs will continue to be lost in our communities until Congress closes this loophole and creates a level playing field.

Earlier this year the Michigan Retailers Association released a study that found that up to 1,600 new jobs would be created in our state if Congress took action. I am troubled that some view this issue as a tax increase – nothing could be further from the truth. This is a collection and fairness issue and it is time to close this loophole and in doing so it will help states like mine avoid the potential of raising other taxes. As I understand it, several states are considering opportunities to use any new revenues from closing this loophole to reduce the overall in-state tax burden. This would be something that all business owners would applaud.

So I am here today asking Congress to pass a national solution that levels the playing field between bricks-and-mortar stores and online-only companies. I am asking that you do this

not only for Marshall Music, but for every single book store, bicycle store and local jewelry store back in your district.

While I am aware this is an oversight hearing, I do note it is within the purview of Congress to fix this problem and protect Main Street jobs. Because of the effect of a 1992 Supreme Court decision (Quill vs. North Dakota), states alone cannot solve this problem. A number of states – California, Texas, Illinois, and South Carolina, to name a few – have recently passed state laws that deal with the unfair treatment between online-only and bricks-and-mortar retailers. The Quill decision, however, limits how far states can go. It is clearly time for, and the responsibility of, Congress to address this at a national level and provide a solution to protect jobs in each of your districts.

In particular, I note that a bipartisan bill, H.R. 3179, the Marketplace Equity Act, gives every state the option to fix this issue. H.R. 3179 allows the 24 states that belong to the Streamlined Sales and Use Tax Agreement to level the playing field. As well, H.R. 3179 gives simple options to the remaining 21 states that are not party to, and many never join, the Streamlined Sales and Use Tax Agreement in order to begin treating all retailers equally. The legislation is a breakthrough in that it supports the rights of individual states to determine what is the best way for them to solve this problem. H.R. 3179 is also supported by a broad range of national associations, state retail organizations, and companies. I have attached a copy of their letter of support to my testimony and would ask that it be submitted for the record.

In closing, I want to thank the Committee for providing me this opportunity to appear before you this morning. Main Street merchants are asking Congress to close this loophole and give us a level playing field to compete on.

I look forward to answering any questions you may have.

November 2, 2011

The Honorable Patty Murray
Co-Chair, Joint Select Committee on Deficit Reduction
U.S. Senate
Washington, DC 20510

The Honorable Jeb Hensarling
Co-Chair, Joint Select Committee on Deficit Reduction
U. S. House of Representatives
Washington, DC 20515

Dear Senator Murray and Representative Hensarling:

The undersigned companies and state and national trade associations write today to ask that you include in your recommendations to the House and Senate a provision that would close a loophole harming traditional bricks-and-mortar retail businesses while assisting the states in collecting approximately $23 billion in uncollected state sales taxes that are currently due on Internet and catalogue sales.

At issue is a decades-old Supreme Court ruling, which was issued in 1992, before the pervasiveness of today's Internet commerce, and which prohibits states from requiring remote sellers to collect sales and use taxes owed on purchases from out-of-state vendors. This loophole has created an uneven playing field for bricks-and-mortar retail businesses that face a price disadvantage, has led to budget shortfalls for states as sales taxes go uncollected, and an undue burden on consumers who do not realize they owe the sales tax if it is not collected by the seller, leaving them to face penalties and increased scrutiny from state auditors. Main street retailers are jeopardized as a result of the insurmountable price disadvantage created by this government subsidy along with 15 million bricks-and-mortar retail jobs and one in 10 jobs related to shopping centers. Recent data suggests that one in four jobs is directly or indirectly related to the retail sector.

Several bills are pending in the House and Senate that would give states the authority to manage their sales tax laws while closing this loophole. H.R. 3179, the Marketplace Equity Act, introduced by Reps. Steve Womack (R-AR) and Jackie Speier (D-CA) provides an option for every state to simplify its sales tax statute and assist vendors with compliance, while providing for a robust small business exemption.

S. 1452 and H.R. 2701, the Main Street Fairness Act, introduced by Sen. Dick Durbin (D-IL) and Rep. John Conyers (D-MI) would sanction a 24-state compact called the Streamlined Sales and Use Tax Agreement, providing these states with authority to require collection on remote sales. Senators Durbin, Enzi, and Alexander are also working on a bi-partisan solution, the Marketplace Fairness Act. While all these bills generally accomplish the same goal, they have one item in common: only Congress can grant this authority to the states.

As you seek solutions to address the federal budget, any final product will undoubtedly have an impact on the states, which are likewise facing their own budget crises. Consistent with the goals of the Joint Select Committee on Deficit Reduction, Congress has an opportunity to help the states resolve their own budget shortfalls by enhancing states' rights over sales tax collection authority and in the process closing a loophole that will level the playing field for all merchants. The Joint Select Committee on Deficit Reduction can easily include this authority in its recommendations to the full House and Senate, and we urge you to do so.

Sincerely,

**NATIONAL TRADE ASSOCIATIONS**

American Booksellers Association

American Specialty Toy Retailing Association

American Veterinary Medical Association

Association for Christian Retail

Food Marketing Institute

Independent Running Retailer Association

International Council of Shopping Centers

National Association of Chain Drug Stores

National Association of College Stores

National Association of Real Estate Investment Trusts

National Bicycle Dealers Association

National Grocers Association

National Home Furnishings Association

National Retail Federation

North American Retail Dealers Association

Outdoor Industry Association (OIA)

Pet Industry Joint Advisory Council

Professional Beauty Association

Real Estate Roundtable

Retail Industry Leaders Association

Soccer Dealer Association

**STATE TRADE ASSOCIATIONS**

Alabama Retail Association

Alliance of Wisconsin Retailers

Arizona Retailers Association

Arkansas Grocers and Retail Merchants Association

California Business Properties Association

California Retailers Association

Carolinas Food Industry Council

Colorado Retail Council

Connecticut Retail Merchants Association

Florida Retail Federation

Georgia Retail Association

Idaho Retailers Association

Illinois Retail Merchants Association

Indiana Retail Council

Iowa Retail Federation

Kentucky Retail Federation

Los Angeles Area Chamber of Commerce

Louisiana Retailers Association

Maryland Retailers Association

Michigan Retailers Association

Minnesota Retail Association

Missouri Retailers Association

Mountains and Plains Independent Booksellers Association

Nebraska Retail Federation

New Atlantic Independent Booksellers Association

New England Independent Booksellers Association

New Jersey Retail Merchants Association

North Carolina Retail Merchants Association

North Dakota Retail Association

Ohio Council of Retail Merchants

Pacific Northwest Booksellers Association

Pennsylvania Retailers' Association

Retail Association of Mississippi

Retail Association of Nevada

Retail Council of New York State

Retail Merchants of Hawaii

Retailers Association of Massachusetts

Rhode Island Retail Federation

South Carolina Retail Merchants Association

South Dakota Retailers Association

Southern Independent Booksellers Alliance

Tennessee Retail Association

Texas Retailers Association

Utah Food Industry Association

Utah Retail Merchants Association

Vermont Retail Association

Virginia Retail Merchants Association

Washington Retail Association

West Virginia Retailers Association

Wyoming Retail Association

**COMPANIES**

Abbell Credit Corporation, Chicago, IL

Acadia Realty Trust, White Plains, NY

AutoZone

Barnes and Noble

Bed, Bath, & Beyond

Best Buy

Blake Hunt Ventures, Inc., Danville, CA

John Bucksbaum, Private Real Estate Investor/Developer, Former Chairman and CEO of General Growth Properties, Inc., Chicago, IL

Build-A-Bear Workshop®, Saint Louis, MO

CBL & Associates Properties, Inc., Chattanooga, TN

Cencor Realty Services, Dallas, TX

Chesterfield Blue Valley, LLC, St. Louis, MO

The Container Store, Dallas, Texas

The CortiGilchrist Partnership, llc, Al Corti, Principal, San Diego, CA

Dick's Sporting Goods

DDR Corp., Beachwood, OH

DLC Management Corp., Tarrytown, NY

Donahue Schriber Realty Group, Costa Mesa, CA

Edens & Avant, Columbia, SC

Evergreen Devco, Inc., Glendale, CA

Fairfield Corporation, Battle Creek, MI

Federal Realty Investment Trust, Rockville, MD

FedTax, David Campbell, CEO

L. Michael Foley and Associates, LLC, La Jolla, CA

Forest City Enterprises, Inc., Cleveland, OH

Gap Inc., San Francisco, CA

Garrison Pacific Properties, San Rafael, CA

General Growth Properties, Chicago, IL

Glimcher Realty Trust, Columbus, OH

The Greeby Companies, Inc., Chicago, IL

Hart Realty Advisers, Inc., Simsbury, CT

David Hocker & Associates, Inc., Owensboro, Kentucky

D. Talmage Hocker, The Hocker Group, Louisville, KY

Kimco Realty Corporation, New Hyde Park, NY

Limited Brands, Columbus OH

Lowes

Malcolm Riley and Associates Los Angeles, CA

Mary Lou Fiala, CEO, Loft Unlimited, Ponte Vedra Beach Florida

Marketing Developments, Inc. MI

Planning Developments, Inc. MI

JC Penney

Petco

The Pratt Company, Mill Valley, CA

The Rappaport Companies, McLean, VA

REI (Recreational Equipment, Inc.)

Reininga Corporation, Healdsburg, CA

Safeway, Inc.

Sears Holdings

The Seayco Group, Bentonville, AK

The Sembler Company, St. Petersburg, FL

Simon Property Group, Indianapolis, IN

Steiner + Associates LLC, Columbus, Ohio

Stirling Properties, Covington, LA

Tanger Factory Outlet Centers, Inc., Greensboro, NC

Target Corporation, Minneapolis, MN

Taubman Realty Group, Bloomfield Hills, MI

Tractor Supply Company

Vestar Development Co. - Phoenix AZ

Wal-Mart Stores, Bentonville, AR

The Weitzman Group, Dallas, Texas

Western Development Corporation, Washington, DC

Westfield, LLC., Los Angeles, CA

WDP Partners, LLC, Phoenix, AZ

Wolfe Properties, LLC, St. Louis, MO

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Mr. SMITH. Thank you, Mr. Marshall.
Mr. MARSHALL. Thank you.
Mr. Byrne?

**TESTIMONY OF PATRICK M. BYRNE, CHAIRMAN & CEO, OVERSTOCK.com, INC.**

Mr. BYRNE. Thank you. Good morning, Chairman Smith, Ranking Member Conyers and Members of the Committee.

My name is Patrick Byrne. I am the chairman and CEO of Overstock.com. Thanks for this opportunity to share my views on the question of state authority to collect sales tax on e-commerce.

My basic view is that Brick and Mortar has become 87 percent—I am sorry, big-box has become 87 percent of Brick and Mortar and what is going on here is they are trying to pull up the drawbridge after them. They are trying to get a law passed that will suppress competition from small remote sellers and just Internet sellers in general.

For that reason, Overstock supports the current law as supported in the Supreme Court's *Quill* decision because it facilitated the advent of vibrant innovative e-retailers like Overstock, Newegg, eBay and Amazon.

We oppose the bills now pending in Congress that would empower states to conscript remote retailers to become sales tax collectors and believe that had such remote sales obligations existed when we launched in 1999 we would not be here today.

In 1999, we had 18 employees, carried 100 products and had $1.8 million in revenue. If we had been required to administer and collect sales tax on behalf of remote state governments without meaningful simplification, indemnity and compensation, our chances of becoming an employer of 1,500 American workers that we are today would have been small.

Too high a hurdle would have been established by the cost of compliance in 9,746 taxing jurisdictions—the unavailability—the unavailability of affordable off-the-shelf software solutions, the cost of employing people to implement and manage the software, the Administration and resolution of state audits and resulting assessments and the risk of penalties and lawsuits by plaintiff or attorneys for software errors and omissions.

The question the Committee must consider is whether this innovation will continue if Congress alters current law by allowing states to burden interstate commerce. In my opinion, the pending bills allow states to shirk their responsibilities to collect taxes that they impose on consumers; instead, enforce that burden onto nonresident and nonvoting businesses. Passage of such legislation would poison the Internet's fertile ground for new innovative e-commerce firms.

More specifically, we oppose the pending bills because we believe the taxing jurisdiction should be responsible for collecting taxes from residents and should not unilaterally outsource to retailers without compensation for the burden of collecting taxes from residents of states where those retailers have no presence.

The absence of any nexus threshold in the pending bills makes remote sales tax collection a burden on innovation, entry and commerce.

However, if a majority in Congress is determined to replace current law, Overstock believes that a fair legislative solution must include three essential elements.

First, because tax collection is really a function of states and not retailers, the states should be required to provide a truly plug-and-play software solution.

Supporters of the pending bill claim such solutions are readily available in the marketplace but the fact is they are not. For example, we have been considering opening a warehouse in Kentucky. In preparation, we acquired what was described as an affordable plug-and-play software package that would ensure we were in compliance with the tax collection obligations for sales to Kentucky residents.

The reality is that the so-called off-the-shelf software required $300,000 of investment and months of man hours of our developers to build.

Implementation for the Nation's nearly 10,000 different taxing jurisdictions would be extraordinarily costly for companies like mine, not to mention companies with fewer resources.

So if states want us to collect tax on our sales to their residents when we have no presence there, they should supply software that makes it possible to do so and I believe such software today is vaporware, by the way. They tell you this exists. It is vaporware.

Second, retailers should be liable to state or—should not be liable to state or plaintiff lawsuits if errors arise from use of such software like missing a tax holiday or a new tax rate, the fact that one city in a state taxes the sale of a product one way while another exempts it from taxation.

And third, taxing authorities should compensate all retailers asked to implement state software and to collect sales tax on their behalf. It is expensive to implement software and expensive to collect and remit the tax to the jurisdiction.

Just as I cannot force other parties to work for free, states should not be permitted to compel companies to do their work without reimbursement and without some degree of revenue sharing.

I have attached to my written testimony a draft bill incorporating these principles. I believe it will garner support from the majority of e-commerce companies as well as many Brick and Mortar and Brick and Click retailers, particularly smaller and mid-sized Main Street retailers who would otherwise be hurt by the pending bills.

Thank you for the opportunity to share my views and I look forward to answering your questions.

[The prepared statement of Mr. Byrne follows:]

Before the House Committee on the Judiciary

Testimony of Dr. Patrick M. Byrne
Chairman and CEO
Overstock.com, Inc.

**Constitutional Limitations on States' Authority to Collect Sales Taxes in E-Commerce**

November 30, 2011

Chairman Smith and Members of the Committee,

My name is Dr. Patrick M. Byrne. I am the Chairman and CEO of Overstock.com, Inc., an E-commerce retailer which last year had 1,500 employees, $1.1 billion in revenue and $14 million in net income. Thank you for the invitation to testify today as the Committee explores the constitutional limitations on states' authority to impose sales tax collection obligations on non-resident E-commerce retailers like Overstock. I have views on this subject because, from my experience, I believe that if the proposed collection obligations had existed in October 1999 when Overstock.com launched, we would likely not be here today. The odds against a new online business being successful are long in any case, but requiring online businesses to collect sales tax on behalf of remote state governments without remuneration, simplification and indemnity, make those odds even slimmer. So I appreciate this opportunity to share my views on this subject.

**About Overstock**

Overstock is a publicly traded Utah-based Internet retailer that launched in 1999 with 18 employees and $1.8 million in sales. In 2010, Overstock had 1,500 employees, all in Utah, $1.1 billion of revenues, and $14 million of net income. We offer a wide variety of high-quality, brand-name merchandise and services at discount prices, including bedding, home decor, appliances, watches, jewelry, electronics, sporting goods, clothing, shoes, cars, vacations and insurance. We give customers an opportunity to shop for bargains conveniently, while offering manufacturers, distributors and other retailers an alternative sales channel.

In 1999, we offered less than 100 products for sale; today the number is about 1 million. For each of the last six years, various industry groups, including the National Retail Federation and American Express, have routinely ranked Overstock as #1, 2, 3, or 4 in customer satisfaction among all U.S. retailers, online and off. In 2010, Forbes ranked Overstock as the number one retailer in employee satisfaction, and Glassdoor ranked Overstock ninth in its list of top 50 corporations in America to work.

We have long been noted for our corporate social responsibility. In 2001, we launched Worldstock Fair Trade, Overstock's socially responsible store for products handcrafted by artisans from developing nations and rural areas of the USA. The department distinguishes itself from its competitors by returning between 60-70% of the sales price to the artisans. To date, we have returned more than $73 million to Worldstock's artisan suppliers. We donate all profits from Worldstock to charity, and we use most to build schools and orphanages in some of the poorest nations in the world. For us to be here today, my colleagues at Overstock have had to be fanatics about service, adaptation, and innovation.

**The Burden of Remote State Sales Tax Collection**

The question the Committee must consider is whether innovative remote sale companies will emerge, employ Americans, and help our economy grow if Congress alters the status quo by allowing states to burden interstate commerce. In my opinion, the pending bills allow states to shirk their responsibility to administer and collect the taxes they impose on the taxable "end consumer." Instead, they pass that burden on to non-resident, non-voting businesses. Passage of such legislation would curtail the emergence of the next innovative E-commerce company and poison the Internet's fertile ground for growth and innovation.

Overstock is physically present only in Utah. All of our operations, servers, and employees are located in Utah. As I have already indicated, if when we launched in 1999 and had only $1.8 million of revenue, we had been required in states in which we had no presence to calculate and collect sales tax in thousands of separate taxing districts, respecting their thousands of unique taxing practices and tax holidays, we would not have survived to grow and provide the 1,500 jobs we now do. The cost of compliance in what is currently reported as 9,746 taxing jurisdictions, the unavailability—even today—of affordable off-the-shelf plug-and-play software solutions, the cost of employing and training people to implement and run the software, the administration and resolution of state audits and resulting assessments, and the risk of penalties and suits by plaintiff bar attorneys for software errors and omissions, would have been too high a hurdle to overcome. I imagine the same could be said for Newegg, Amazon, eBay and other E-commerce start-up companies that have blossomed over the last decade.

We oppose the pending bills because they "outsource" to retailers, without compensation, the burden of collecting taxes from residents of states where those retailers have no physical presence nexus. The absence of a physical presence nexus requirement, the long-standing Constitutional standard to be met before states may impose burdens of taxation beyond their borders, makes remote sales tax collection a burden on innovation, entry, and commerce. The taxing jurisdiction should be primarily, if not exclusively, responsible for collecting sales tax from its residents. If states want or need to hire retailers to collect sales taxes from their residents, true "fairness" requires that the states provide them with: (1) plug-and-play software

solutions, (2) indemnification from computation, collection, and administration errors, and (3) compensation for doing the tax collection work on behalf of those states.

**Why Nexus is Critical**

It is unfair to allow states the ability to impose collection obligations on remote E-commerce retailers that have no physical nexus with the state. Imposing such an obligation on a company that has no political say in the taxing decision, the election of state and local officials who make that decision, or how the tax revenues are used, is about as perfect a definition of taxation without representation as can be devised in the 21st Century.

For a remote seller, determining what transactions are taxable and at what rate in a given jurisdiction is extremely complex. For example, we sell gift baskets. Some of the nearly 10,000 taxing jurisdictions impose sales tax on the entire basket of goods, others exempt food products from taxation, and others treat some of the products as candy subject to a higher tax. I trust you see the problem. Back-to-school sales tax holidays for clothes and supplies are another example. It is far easier for retailers with a physical presence in a jurisdiction to know the tax nuances of their jurisdiction. But it is vastly more complex for an E-commerce retailer with thousands or millions of products to know the specifics of the nearly 10,000 taxing authorities where they are not physically present. Thus, if Congress allows states to shift the sales tax collection obligation to retailers, it must require that states supply the software solution. Failure to do so exacerbates the heavy burden to entry of startups and small businesses.

**The Status Quo is a Success**

In *Quill Corp. v. North Dakota,* 504 U.S. 298 (1992), the U. S. Supreme Court articulated a bright-line physical presence requirement before North Dakota could impose a collection burden on an out-of-state mail order business (a business model nearly identical to online retailers). The Court stated:

> Moreover, a bright-line rule in the area of sales and use taxes also encourages settled expectations and, in doing so, fosters investment by businesses and individuals. Indeed, it is not unlikely that the mail-order industry's dramatic growth over the last quarter-century is due in part to the bright-line exemption from state taxation created in *Bellas Hess*.

The physical presence standard of *Quill* has worked successfully, enabling technology companies like Overstock to innovate and thrive in the retail marketplace, bring unprecedented value, choice and convenience to consumers, and enable small retail stores throughout the country to supplement their sales through our web sites.

**A Fairer Approach if a Federal Solution is Essential**

Given these benefits, it is difficult for me to understand why Congress would pass legislation that creates insurmountable hurdles for new entrants and ideas. If, nevertheless, a majority in Congress wants to upset the status quo, Overstock believes that a fair legislative package must include the following elements.

1. First, because tax collection is really a duty of states and not retailers, the states should be required to provide a truly plug-and-play affordable software solution. Proponents of the pending legislation say such solutions are readily available in the marketplace, so this should not be a problem. The truth is, however, that they are not. I speak from recent experience at Overstock. We have been considering creating nexus in the state of Kentucky. In preparation for that event, we acquired what was described as an affordable plug-and-play software package that would ensure we were in compliance with the sales tax collection obligations for online sales to residents of the new jurisdiction. The off-the-shelf software required approximately $300,000 of investment and months of man-hours of our IT staff to build. Implementation of this solution for the nation's nearly 10,000 different taxing jurisdictions would be extraordinarily costly for companies like ours. So if states want to tax our sales to their residents when we have no physical presence there, they should bear the cost of supplying the software.

2. Second, we should not be held liable to the states or to plaintiff law suits if errors arise from use of software solutions they provide, like missing a tax holiday, or a new tax rate, or the fact that one city in the state taxes candy while another does not.

3. Third, taxing authorities should compensate all retailers whom they require to collect sales taxes. There are significant costs associated with collecting and remitting the tax to the jurisdiction. Just as I cannot force my colleagues to work for free, states should not be allowed, in essence, to force-hire companies to do their work without expense reimbursement and some degree of revenue sharing.

In the event that Congress opts to end the status quo in favor of a federal solution for sales tax collection, Overstock has prepared the attached draft bill incorporating the principles that I have outlined. We believe that it should garner the support of the majority of E-commerce companies, as well as many bricks and mortar and bricks and clicks retailers, particularly smaller and mid-sized main street retailers who are otherwise hurt by the currently proposed bills.

**Conclusion**

Thank you, Chairman Smith, for inviting me to share Overstock.com's views on the sales tax issue. I truly appreciate this opportunity. I would be pleased to answer any questions you or Members of the Committee have. Overstock is eager to remain engaged in this debate.



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Mr. SMITH. Thank you, Mr. Byrnes.
Mr. Otto?

**TESTIMONY OF THE HONORABLE JOHN OTTO,
TEXAS STATE HOUSE OF REPRESENTATIVES**

Mr. OTTO. Thank you, Chairman Smith and Ranking Member Conyers and Members of the Committee.

Since 1992, the *Quill* decision has been the law of the land and physical presence has been the measuring stick for whether or not a retailer has to collect sales tax.

Over the last 19 years, technology has advanced in the marketplace to the point that a physical presence can largely be controlled and isolated to a few states while selling into many states.

If you doubt that, you have two online retailers here would be—I would be curious to know how many states they sell into versus how many that are actually claiming a physical presence and collecting tax in.

If action is not taken and *Quill* is allowed to remain the law of the land, then are we not picking winners and losers within the retail sector?

H.R. 3179, in my opinion, levels the playing field while protecting states' rights, and that is very important here on the protection of states' rights. Previous legislation that has been introduced in Congress has contained the requirement that a state join the Streamlined Sales Tax compact in order to receive the benefits of that legislation.

While I fully support the rights of states to join the compact, I do not believe a state should be forced into joining the compact in order to receive the benefit of such legislation. H.R. 3179 leaves it up to each state whether they wish to join the compact or not.

Let me also point out that, in my opinion, the Streamlined states will comply with the requirements of H.R. 3179 as soon as they adopt a small-business exemption. So they are at a distinct advantage in regards to how quickly they could implement H.R. 3179.

Now, let me address briefly why I think H.R. 3179 best serves the interest of states. It requires a small-business exemption, it requires a uniform tax base rules within a state, i.e., what is and is not taxable, it requires for centralized filing and remitting within a state and it also offers options on the tax rates.

It can be a state-only rate. If you cannot get your local jurisdictions to comply with these other three requirements then the state could implement a state-only rate.

It also has a blended rate possibility as well as an address-based rate with software made available to the retail sector. In my opinion, the requirement for a uniform tax base within a state is desirable. It may cause delays in implementing the provisions of H.R. 3179 in some states.

This is going to be the biggest issue if legislation is passed is how can states implement this and over what time period.

In Texas, we don't meet again until 2013. It will take several legislative sessions in order to bring about the changes to get to a uniform tax base if we wanted to go down to collecting the local taxing jurisdictions as well.

So, therefore, I believe that the flexibility that is provided in H.R. 3179 best serves the interest of the states in allowing us to level this playing field.

You know, I don't fault anybody that is taking advantage of *Quill*. They fall within the law.

The problem is the marketplace has changed in 19 years and we have not. And if we are going to be fair, you know, what encourage-

ment am I offering to my local business in Dayton, Texas, to build a storefront as opposed to strictly putting his business online?

And those are the—those are the kinds of businesses that support the local community. They have a physical presence there. They are the contributors to the Little League, the PTA. They are the people—they are also the ones that employ my local people and my local citizens.

So that is why it is most important to me that a bill that would follow the guidelines as set out in H.R. 3179 that if Congress is going to take action this is by far, in my opinion, the best legislation I have seen proposed to assist the states in addressing this issue.

Thank you.

[The prepared statement of Mr. Otto follows:]

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WRITTEN TESTIMONY OF JOHN OTTO

STATE REPRESENTATIVE OF HOUSE DISTRICT 18

BEFORE THE

COMMITTEE ON THE JUDICIARY
THE UNITED STATES HOUSE OF REPRESENTATIVES

HEARING ON

CONSTITUTIONAL LIMITATIONS ON STATES' AUTHORITY
TO COLLECT SALES TAXES IN E-COMMERCE

NOVEMBER 30, 2011



Mr. Chairman and members of the committee, thank you for the opportunity to testify today regarding the issue of Constitutional Limitations on States' Authority to Collect Sales Taxes in E-Commerce. My name is John Otto. I am a certified public accountant serving my fourth term in the Texas House of Representatives, where I serve as vice-chairman of the Committee on Ways and Means and as a subcommittee chair on the House Appropriations Committee. I am employed by Ryan, a tax advisory and consulting firm with the largest indirect tax practice in North America. I am pleased today to testify in my capacity as a State Representative.

During the 82nd Legislative Session in Texas this year, I carried legislation to more clearly define the nexus statutes and physical presence. My changes were somewhat conservative compared to what other states were attempting in that I did not include "affiliated marketers" as establishing nexus in Texas, but did address a retailer (including any 50% or more controlled affiliated entity) who had physical presence by means other than a retail store front. The definition included "distribution centers" specifically as constituting physical presence. The legislation was supported by 125 of 150 House members and 30 of 31 Senators. Each state is reacting to the current market place in its own way, but we are constrained at the end of the day by the *Quill* decision.

In 1992, the U.S. Supreme Court opined in *Quill Corp. v. North Dakota* that a retailer does not have an obligation to collect sales tax if they have no "physical presence." Since then, the *Quill* decision has been the law of the land and "physical presence" has been the measuring stick for whether or not a retailer has to collect sales tax. Quoting from the Supreme Court's decision in *Quill* regarding the reasons the justices disagreed with the North Dakota Supreme Court's decision **"This aspect of our decision is made easier by the fact that the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve."** I believe this opinion shows that the ball is in your court.

Over the last 19 years technology has advanced in the marketplace to the point that physical presence can largely be controlled and isolated to a few states while selling into many states. If action is not taken and *Quill* is allowed to remain the law of the land, then are we not picking winners and losers within the retail sector? How is a retailer, such as Bed, Bath and Beyond, J.C. Penny or Wal-Mart supposed to compete with

Amazon.com, Blue Nile.com or Overtstocked.com when the latter enjoy anywhere from an 8-10% discount due to not having to collect sales tax. And all of the companies I have listed as storefront retailers also conduct sales over the internet and currently collect tax on those sales. This current law and policy discourages the continued development of the very brick and mortar establishments that support our state and local communities in numerous ways. This issue of fairness should be addressed and I believe that H.R. 3179 does that.

H.R. 3179, in my opinion, levels the playing field while protecting states' rights. Previous legislation that has been introduced in Congress has contained the requirement that a state join the Streamlined Sales Tax compact in order to receive the benefits of that legislation. While I fully support the rights of states to join the compact, I do not believe a state should be forced into joining the compact in order to receive the benefit of such legislation. As a state representative I am not willing to turn over to an unelected, nonpolitical body the right to determine what items will be subject to sales and use tax within my state. H.R. 3179 leaves it up to each state whether they wish to join the compact or not. Let me also point out that in my opinion the Streamlined states will comply with the requirements of H.R. 3179 as soon as they adopt a small business exemption. So they are at a distinct advantage in regards to how quickly they can implement H.R. 3179.

The provisions of H.R. 3179 basically have four minimum requirements for a state to avail itself of the benefits provided in this legislation:

1. Small business exemption
2. Uniform tax base rules within a state – what is and is not taxable
3. Centralized filing and remitting within a state
4. Tax rates: Either -
    - State rate only (not local)
    - Blended rate – state and partial local rates
    - Address-based rate with software made available

In my opinion the requirement for a uniform tax base within a state (which is desirable) may cause delays in implementing the provisions of H.R. 3179 for some states, unless the tax rate options are included in the final legislation. In Texas, locals may tax residential electricity and may not impose tax on interstate telecommunications services and satellite television services. Some other states may have similar situations in which locals may impose their tax on something the state does not (example: Chicago's tax of soft drink cans).

Also, some states permit locals to "opt out" of sales tax holidays and this proposal would appear to preclude that. One solution, to all of the issues just discussed, is for a state to adopt the state only rate or blended rate and have it apply to the state definitions of what is taxable. Because H.R. 3179 requires uniform tax base rules, this needs to be clarified in the final legislation that the uniformity of state and local would only apply should the state choose an address based rate with software made available. The bill also states that local taxing jurisdictions cannot require remote sellers to file returns which may affect states like California, Arizona, Louisiana and Colorado, unless they adopt the state rate only or blended rate. I cannot overemphasize how important I believe it is that the final legislation include all three of the proposed methods of taxation. Adopting the addressed-based rate with software made available as the only method available to states will have a significant impact on which states can participate and how quickly they can comply.

Finally, let me address the revenue side of the equation as it relates to state governments. I know some people will call this a new tax, but it is not. This is a tax that has been due from the consumer, when the retailer is not required to collect it, since sales and use taxes were put into law. Businesses for the most part are already paying the use tax because they are subject to audit if they hold a sales tax permit. With the ever increasing likelihood that states are going to find lesser amounts of federal revenues available to them as you attempt to reduce federal spending, wouldn't it make sense to allow states to have retailers collect a tax that is already in law? Before I vote to increase a state sales tax rate that would only increase the current disparity between local and out of state retailers, it only makes sense to first collect the taxes states are already due. H.R. 3179 helps states accomplish that.

Thank you Mr. Chairman and members of the committee for allowing me to testify today. I would now be happy to answer any questions you might have.

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Mr. SMITH. Thank you, Mr. Otto.
Mr. Cohen?

**TESTIMONY OF TOD COHEN, VICE PRESIDENT AND DEPUTY GENERAL COUNSEL, GLOBAL GOVERNMENT RELATIONS, INTELLECTUAL PROPERTY, REGULATORY AND ASSET PROTECTION, eBAY INC.**

Mr. COHEN. Chairman Smith, Ranking Member Conyers and Members of the Committee, my name is Tod Cohen and I am the vice president of global government relations and deputy general counsel of eBay, Inc.

eBay empowers and connects millions of buyers and sellers across the globe. Ebay's priority on remote sales tax policies has always been the treatment of small-business retailers. Hundreds of thousands of small businesses and entrepreneurs across America use eBay to engage in commerce.

Protecting the ability of small-business retailers to play a meaningful role in the 21st-century marketplace creates jobs, fosters competition and promotes innovation. The Internet and mobile technology is, clearly, a part of every retail business model going forward. This is true for small, mid-size and giant retailers.

Small-business retailers have used the Internet to survive and grow outside of their traditional markets. The remote sales tax debate is decades old. While the pro-tax rhetoric largely stays the same, the world of retail has changed around it.

The idea that this debate is about the Internet versus offline stores is a false paradigm. All retail business models large and small use the Internet. They also involve physical facilities like stores, warehouses, management offices or distribution centers.

A term you should be comfortable using is Brick and Click retail. It means a network of stores, Web and technology services all combined in a single retail business model. Large in-store retailers in America operate Brick and Click businesses.

To give some perspective, 93 percent of retail goes on in stores while 7 percent is exclusively online. But almost 45 percent of in-store sales are Web enabled and that is exploding. Big and small retailers offer consumers different benefits on different scales and their models come with different costs.

Giant billion-dollar retailers with national store or distribution networks offer services like same-day delivery, lower cost shipping and in-store returns of items bought online. Being giant creates an economy of scale that has advantages.

The largest retailers on the Internet including Bricks and Clicks are growing their market share. In fact, national Brick and Click retailers are 18 of the top 25 retail websites. Amazon's version of a Brick and Click is based on its distribution centers.

Small-business retailers are losing market share even under the sales tax status quo. As has been the case for decades, the fundamental threat to small independent retailers is coming from billion-dollar competitors, not other small businesses. You hear a lot about fairness in this debate as if sameness is equal to fairness. It is not.

Different sized businesses face very different conditions and different rules. In retail, small businesses on the Internet face higher shipping costs, higher product costs and difficulties dealing with returns. Retail competition is about more than remote sales taxes.

Today, the benefits of local presence come with a tax cost. Honestly, that is fair. If remote sales tax laws changed without pro-

tecting small businesses, consumers will face a new tax cost on goods purchased from small remote retailers.

But the consumer will not gain any retail benefits tied to physical presence. Without a small-business exemption, remote sales taxes will tip the scales further against small-business retailers and benefit the largest retailers that have the most facilities.

That is why retailers with national store or distribution networks support changing current law. Current law regarding remote sales tax authority is not perfect.

A few large retailers, Amazon, for example, have not operated in the spirit of the law and link sales tax collection to physical presence.

Some states have used tax-related incentives to encourage large-retailer investments without offering similar investments incentives to small businesses that fulfill their in-state tax obligations. That is not fair.

Congress has the power to address inequities among a few giant retailers without putting a new tax barrier in front of small-business retailers. A real small-business exemption and a Federal law reversing the *Quill* decision would meet that goal.

Remember, there will always be small-business retailers that you want to protect and you want to grow. It is where tomorrow's big retailers come from. Protecting small businesses from regulatory and tax burdens is not a new concept.

This is a traditional bipartisan legislative goal. House Resolution 95, sponsored by Representatives Lungren and Lofgren, is in that spirit. They are championing small-business retailers with their resolution. It retains an aspect of current law that works.

eBay stands willing to work with the Committee to ensure that any changes in remote sales tax law include meaningful small-business protections that create an opening for small retailers to grow into the next billion-dollar businesses.

I appreciate the opportunity to testify before the Committee and I look forward to your questions.

[The prepared statement of Mr. Cohen follows:]

*Testimony of*

**Tod Cohen**

**Vice President and Deputy General Counsel, Government Relations**

**eBay Inc.**

*Before the*

**United States House of Representatives Committee on the Judiciary**

**"Constitutional Limitations on States' Authority to Collect Sales Taxes in E-Commerce"**

***Presented*:**

**Rayburn House Office Building, Room 2141**

**November 30, 2011**

**10:00 AM**

Chairman Smith, Ranking Member Conyers, and Members of the Committee: Thank you for the opportunity to testify today about the impact of remote sales tax policies on small businesses that use the eBay platform and the Internet more generally.

My name is Tod Cohen and I am the Vice President of Global Government Relations and Deputy General Counsel for eBay Inc. eBay Inc. was founded in 1995 and is headquartered in San Jose, California. Our business connects millions of buyers and sellers across the globe everyday through the eBay platform, which is the world's largest online marketplace; through PayPal, which enables individuals and businesses to securely, easily and quickly send and receive online payments; and through GSI Commerce, which facilitates e-commerce, multichannel retailing and digital marketing for global enterprises. We also reach millions of consumers through specialized marketplaces such as StubHub, the world's largest ticket marketplace; and eBay Classifieds sites, which together are available in more than 1,000 cities around the world.

Among those that use the eBay platform are hundreds of thousands of U.S. small businesses and entrepreneurs located in every state and congressional district across the country. The Internet and the eBay marketplace provide these small businesses and entrepreneurs with relatively low-cost access to potential buyers far outside the limits of their traditional geographic footprint. eBay cares about the remote sales tax impacts on these small business retailers and entrepreneurs because they have always been at the heart of the eBay business model. Our success is tied directly to their success. The ability of small business retail to play a meaningful role in the 21st Century retail marketplace is critical for expanding retail competition, developing new businesses and better serving consumers.

Technology and the Internet are now central to almost every retail business model. This is true for small businesses. This is true for mid-size retailers. This is true for retail giants. eBay Inc. is a technology company that enables all size retailers to compete better, but our focus today is on the small business retailers. Internet and mobile technology is critical to their long-term success. By opening up new markets, the Internet empowers small businesses to grow outside of traditionally disadvantaged communities and compete nationwide. eBay and the Internet also open international markets to small business retailers in ways unimaginable just fifteen years ago. In fact, 20% of sales occurring on the eBay platform are cross-border commerce and 90% of small business retailers that use the eBay marketplace export.

Small online businesses provide consumers with greater product selection, competitive prices and convenience. Simply put, more choice for consumers. Especially in this tough economy, consumer choice is more important than ever before.

The debate about remote sales tax policy on the Internet stretches back over a decade. It is basically as old as the commercial Internet itself. While much of the rhetoric fueling the call for increased remote sales tax collection has stood still, the world of retail has changed. Retail businesses, large and small, have fundamentally changed. The very idea that this debate is about "The Internet" v. "Stores" is a false paradigm. All sustainable 21st Century retail business models, large and small alike, use the Internet and other technology tools. All 21st Century retail

business models use some physical facilities, whether stores, management offices or distribution centers.

Please look beyond the outdated rhetoric and look at the data, as you consider this issue. First, stores matter and they don't stand alone. They are being combined with technology and web services. The data is unchallenged, most retail still happens in stores. The Census Bureau and Forrester Research shows that in-store retail will represent 93% of all retail in 2012, while online retail is just 7%.[1]

The story of retail competition did not begin with the Internet, as you all know. You also know that the face of retail has changed dramatically over the past four decades. At the heart of the story has been the expanding dominance of giant retailers at the expense of small business. Giants have grown more dominant in retail; small independent retailers have been pushed to the edges. To illustrate, big-box discount retailers accounted for 42% of total retail sales in 1987. As of July 2010, their market share had jumped to 87%.[2] Technology has been part of that story. Today, technology can empower small retailers, and you should support that. At the same time, Internet-based retail is increasingly dominated by giants.

There is a term in the world of 21st Century retail that you should be comfortable using. It is called "Brick & Click" retail. It means a network of stores, web and technology services all combined in a single retail business. Essentially, every large retailer in America operates a "Brick & Click" business. As noted, 93% of retail occurs in stores. Another key data-point is that nearly 45% of those in-store sales are web-influenced.[3] Consumers use their mobile devices and computers to find what they want to buy, locate the store where it is available for the best combination of price and convenience, and they buy it. "Brick & Click" retail is a growing and vibrant retail business model.

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[1] Forrester Research: Web-Influenced Retail Sales Forecast 2010-2015 (US).
[2] ConsumerReports.org. (July 2010). *America's Top Stores: 30,000 Readers Reveal the Best Places to Shop for Practically Anything.* Consumer Reports
[3] Forrester Research: Web-Influenced Retail Sales Forecast 2010-2015 (US).

The largest "Brick & Click" retailers are the same retail giants that dominate in-store sales. This is not some conspiracy. These are giant and successful retailers that dominated the business in the late 20th Century and they are doing their best to adapt to new technology services and consumer needs. The retail giants make up 18 of the Top 25 retail websites today, and they are trying to use mobile services, social networking and other technologies to better compete.[4] And eBay Inc. is working hard to enable them and almost all other retailers of whatever size to succeed in that effort.

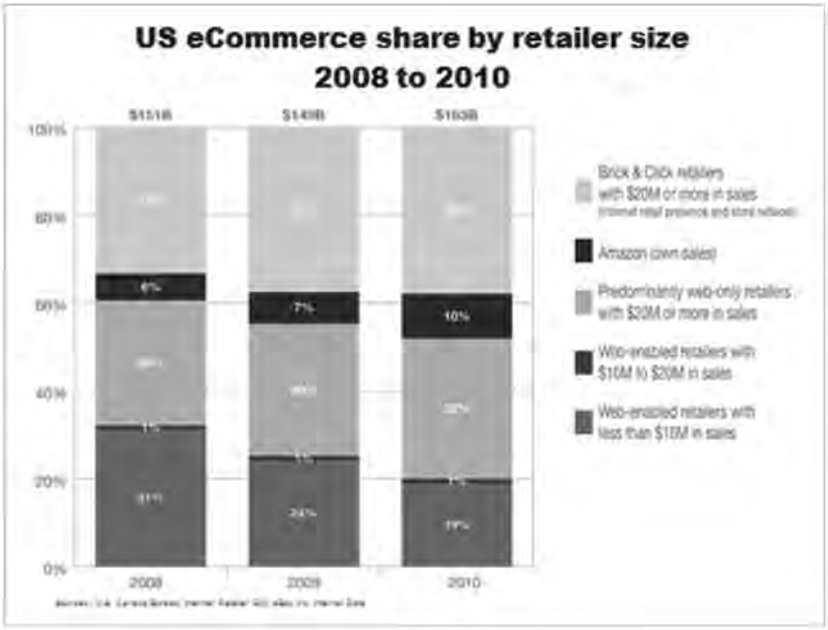
The majority of small business retailers are doing the same thing as their larger competitors, just on a much smaller scale. Like their larger counterparts, small retailers are combining a store, or a few stores, a warehouse, or even their garage, with technology services to try to compete. They face a completely different competitive landscape and cost equation than the giants do. Big and small retailers offer consumers different benefits and their models come with different costs.

The giant billion-dollar retailers with their national stores or distribution networks can offer key services like in-store pick up, same day delivery, free or significantly lower-cost shipping, and in-store returns of items bought online. Consumers value those features, and the biggest of the big are better positioned to offer those services. In retail, being giant has its advantages today just as it did four decades ago. Again, the data does not lie. The largest retailer on the Internet, Amazon, is a business with a national network of facilities, and is growing fastest. The giant "Brick & Click" retailers are also growing their market share online. In short, while small business retailers are active online and are adopting technology, they are not winning the race under the status quo.

Just look at this chart describing e-commerce for the previous three years. The share of online sales being done by retailers with less than $20 million in sales is falling. Under the current mix of business costs, including the remote sales tax rules, the small business competitors are not taking over the field. Instead, it is the largest retailers that are growing. And not surprisingly, those giant retailers are lined up united in proposing a change in remote sales tax

[4] Internet Retailer. http://www.internetretailer.com/top500/list/

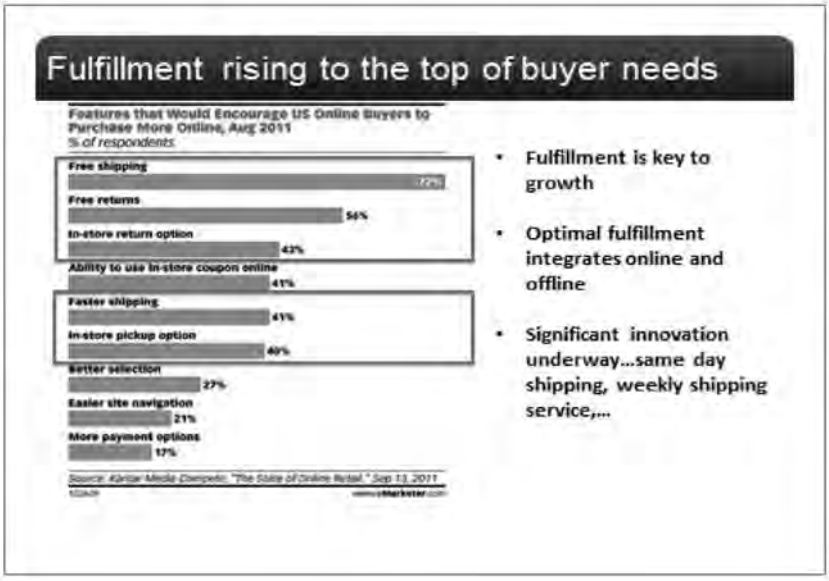
law that will harm the smaller retailers who do not have national physical presence. If small business retailers using the Internet were gaining unfair advantages from current remote sales tax laws, one would expect that their share of Internet sales would be growing. But it is not. Just as importantly, the idea that small business retailers on the Internet are a threat to the survival of small business store fronts is ridiculous. The threat to small independent retailers is coming from giant multi-billion dollar competitors online and offline, which has been the case for nearly half a century.




You hear a lot about fairness in this debate. Some have claimed that a "level playing field" means all retailers using the Internet should be held to the same remote sales tax standard. However, sameness is not fairness. Small businesses retailers face many competitive disadvantages when compared to larger retailers. They have proportionally higher costs of doing

business, including providing employee benefits. And one must especially consider the costs of shipping, when considering the playing field for small e-commerce businesses,. Shipping prices, as with other costs, are directly related to sales volumes and how close the retailers is to the customer.

Furthermore, customer shopping preferences show that many of the advantages of being a very large retailer are gaining in importance. Again, there are reasons why the largest retailers are growing their share of e-commerce. There are real world benefits to being very big and combining physical assets with online shopping. A recent survey of online shoppers by Kantar Media asked consumers to list services that will encourage them to shop more online. Five of the top six responses are tied directly to having a large physical presence, including in-store returns, in-store pickup and shipping benefits that come from having massive distribution centers near their consumers.



The world of retail is bigger than remote state sales taxes. When you think big picture, the higher shipping costs alone often tip the balance away from smaller retailers. There are also many direct tax benefits enjoyed by the largest retailers that never flow down to their small business competitors. These include state and local property tax breaks and sales tax exclusions. Do those who want a "level playing field" demand that all small business retailers get the same tax credits, the same sales tax exclusions and the same shipping rates? If and when they do, we will be the first to endorse changing *Quill* and lifting the prohibition against remote sales tax collection and remittance.

In short, physical presence brings real world benefits to retailers. Small retailers tend to have very limited physical presence. They enjoy the benefits of physical presence in one or two locations at most. Giant retailers have national store or distribution networks, and they enjoy the benefits over a large number of states and communities. Today, the retail benefits of physical presence come with a tax cost, and retail businesses have understood that rule for years.

The Internet sales tax bills that have been introduced in this Congress would change the playing field in a way that would apply sales taxes to small business retailers in the same manner as giant retailers. This change in law would mean that consumers would face a new tax cost on goods purchased from small remote retailers, but the consumer would not gain benefits tied to presence. This means that the shopper will be less likely to buy from small retailers on the Internet. The real world effect will be to disadvantage small business retailers, a segment of retailers that is already losing market share under the status quo. This is why these bills are anti-small business.

Current law regarding remote state sales tax authority is not perfect, and there have been problems. A few large online retailers have not operated in the spirit of the law, failing to collect sales taxes where they have physical presence. However, their smaller competitors are and do collect and remit sales taxes for purchases made both online and offline. Some states have used sales tax-related incentives to encourage local investment by said large retailers. In addition, states have not enforced their consumer Use Tax laws. These are real problems with the current system. But current remote sales tax policies for small business retailers using the Internet are a

positive aspect of the current system. Protecting small business retail from blanket remote sales tax collection is beneficial for retail competition and economic growth, and should be retained in any new remote sales tax regime.

Congress has the power to address abuses and inequities without raising new costs on small business retail entrepreneurs. A real Small Business Exemption would do that. A real Small Business Exemption would protect small retailers who are already falling behind. Permanently protecting small business retailers from national remote sales tax collection burdens will promote new retail competition. Some have said that e-commerce does not need "infant industry protection." While this debate is not about an infant industry, it is about infant and small businesses. And, the reality is that there will always be small business retailers who you want to protect and allow to grow. A true Small Business Exemption will be an incubator for new businesses, who we hope will graduate into any new collection regime.

Protecting small businesses from burdens that will undermine their growth and even directly promoting small business operations is not a new or novel concept. There has traditionally been bipartisan support for small business promotion. There is an entire federal agency aimed at promoting and protecting small businesses, as you well know. Also, small businesses in the last two decades have received preferential treatment in legislation such as the Family Medical Leave Act, the Health Care Reform bills, and the Small Business Jobs Act.

If you believe that small business retailers should not be harmed by a change in remote sales tax law, then the definition of what constitutes a small business that would be preserved from new tax collection requirements is an important one. Congress traditionally delegates authority to the Small Business Administration (SBA) to set small business size standards. The SBA's unique position allows it take into account the intricate differences in diverse business models. Currently, SBA's size standard for small "electronic shopping" businesses is $30 million in total annual sales. The absolute smallest business size standard in the retail space is $7 million, used for single stand-alone newsstands and kiosks.

Every previous remote sales tax proposal until the 111th Congress has included thoughtful protections for small businesses, recognizing the playing field is unequal for small guys,. More specifically, proposals introduced in the 107th through the 110th Congresses included a small business exemption of at least $5 million, or authorized the Small Business Administration to establish the exemption threshold. And there are other widely-accepted small business definitions. As noted, the SBA defines a small retail business as a business that does between $30 million and $7 million in sales, taking into account the business model. Additionally, the Treasury Department has proposed a methodology for defining small businesses that would ultimately set the threshold at $10 million.

Unfortunately, the authors of recent remote sales tax bills have walked away from true small business protections. Starting in 2010, remote sales tax bills dropped the term "Small Business Exemption" and replaced it with the term "small seller exception". They want small businesses to be collecting online everywhere. Obviously, we disagree.

For all of these reasons, eBay strongly supports H.Res. 95. This bipartisan resolution opposes new tax collection requirements for small online businesses and entrepreneurs. The Resolution, which was introduced by your Judiciary colleagues Representatives Lungren and Lofgren, calls for policies to maintain the principle that small businesses with less presence should not be held to the same standard as large retail businesses with significant presence. eBay sincerely appreciates Congressman Lungren's and Congresswoman Lofgren's leadership on this issue. We also appreciate the 31 cosponsors that have declared their support for small business retailers by cosponsoring H.Res. 95.

To conclude, eBay's focus has been to protect small business retailers using the Internet from any new onerous tax burdens. eBay supports robust protections for small business retailers in any new remote sales tax regime, and will continue to urge members of the Committee to do the same.

I appreciate the opportunity to testify before the Committee, and I look forward to your questions.



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Mr. SMITH. Thank you, Mr. Cohen.
Mr. Kenley?

**TESTIMONY OF THE HONORABLE LUKE KENLEY, INDIANA STATE SENATE, ON BEHALF OF STREAMLINED SALES TAX GOVERNING BOARD, INC.**

Mr. KENLEY. Thank you, Mr. Chairman Smith and Ranking Member Conyers and Members of the Judiciary Committee for the invitation to talk to you today.

I chair the Senate Appropriations Committee in Indiana and I am a long-time retailer. I come before you today in my role as someone responsible for producing a balanced state budget, which we do every year in Indiana, for developing a fair and sensible tax policy to support that budget, and as president of the Streamlined Sales Tax Governing Board, the country's most successful business tax simplification initiative, with 24 fully-qualified member states and, I might add, interestingly, about three-fourths of the legislators on that board are Republicans because this is such a pro-business activity.

As a law student at Harvard, when I studied the Bellas Hess case, I never imagined I would be testifying before Congress about the court's interpretation of the Constitution's limits on state sales taxes.

But with the development of the Internet and e-commerce, both wonderful developments for consumers, serious issues for state budgets and for retailers have come to the fore.

Today, local retailers compete with Internet retailers, a development good for consumers, but must do so at a 6 to 10 percent government-mandated price disadvantage through no fault of their own.

In *Quill*, the U.S. Supreme Court made it clear that a state's ability to employ an effective sales tax was going to depend on the authority granted by Congress under the Commerce Clause. I come before you today to ask you to exercise that authority.

In several other cases, the U.S. Supreme Court has made it clear that voluntary agreements among states such as the Streamlined Sales Tax Agreement are constitutional exercises of state authority.

According to the Department of Commerce, e-commerce sales in 2005 were $87 billion. This year, they will total more than $175 billion, more than twice that amount. The quarterly sales of e-commerce have increased on the average 17 percent above last year's figures. Sales on Cyber Monday 2 days ago increased 22 percent over last year.

Retailers across this country often find themselves acting as the display case for consumers who come in, try out the product, solicit information and product comparisons from the local retailer, then go home and buy it online.

In fact, the amazing power of mobile phones allows consumers to scan product codes, check prices and buy a product from online business before they even leave the local store.

Today's technology, with the tremendous advances made in recent years, makes tax collection simple, cheap and reliable. Streamlined, with its uniformity of definitions and procedures, has further enhanced the ease of collection.

We provide free software for companies and our certified service provider system with six qualified providers will provide for free to the small Internet retailer collection and remission services.

In many ways, the Internet is the perfect environment in which to collect sales tax because it is something that can be automated. Any small-business exemption for small Internet retailers will further discriminate against the local small Brick and Mortar businesses who do not receive the exemption.

In any case, with the free collection service offered by Streamlined, the perceived burden is removed. The only remaining burden is that 6 to 10 percent government-mandated price disadvantage placed on local retailers.

Is this a tax increase? Paying a tax you legally owe but were not previously paying is not a tax increase.

This tax is already owed as a use tax in every state with a sales tax by the same thinking. If you refuse to pay or fail to pay a tax already owed, for example, Federal income tax, that would be a tax decrease.

None of us elected officials who have sworn to uphold the Constitution and the laws of the United States are likely to run a campaign on the platform of don't pay your taxes and get a tax decrease.

The obligation to pay exists today, and asking one retailer to collect without asking the same of all retailers doesn't seem like equal protection under the law.

Some say that we should use other ways to collect the tax with a tighter audit system. To me, this feels like overzealous enforcement, practices which seem to invade the consumers' privacy and fails to adhere to our standard belief that most people file their returns with integrity and we trust them to do so.

Three bills have been filed on this subject. There are some differences among the bills that affect businesses in very different ways. The original bill filed by Senator Durbin is the most business friendly in terms of the simplicity and uniformity.

But that bill does not offer an alternative to non-Streamlined states which Streamlined agrees should be available to other states, and we agree with Mr. Otto on that point.

Through the advancement of supporting technology and the work of business and states together, much progress has already been made. The differences reflected in the bills are about the only serious issues left to resolve and those issues are clearly identified.

I come before you today as a state legislator who develops budget and tax policy as a retailer seeking a level playing field to ask you to exercise your authority under the Commerce Clause and grant states the ability to solve these problems.

[The prepared statement of Mr. Kenley follows:]

Testimony of State Senator Howard (Luke) Kenley III before the Judiciary Committee of the United States House of Representatives on November 30, 2011:

Thank you Chairman Smith, Ranking Member Conyers and Members of the Judiciary Committee for the invitation to talk to today about one of the most serious issues facing state authority over their taxes and also one of the most challenging issues in retailing.

**Introduction:**
I am a Republican State Senator from Indiana. I chair of the Senate Appropriations Committee and I am a long-time retailer. I come before you today in my role as someone responsible for producing a balanced state budget and as the president of the country's most successful business tax simplification initiative.

**Background:**
I appreciate the title of today's hearing: "Constitutional Limitations on State's Authority to Collect Sales Taxes on E-Commerce." When I studied the Bellas Hess case in Harvard Law School a few years after the Supreme Court's decision I never imagined I would be testifying before Congress about that Court's interpretation of the Constitution's limitations on state taxes. Unfortunately the intervening years have made this issue even more ominous for state budgets and for retailers. When the Court decided Bellas Hess this was a catalog issue and while catalogs offered greater variety than many stores, catalogs could not compete with local customer service and immediate availability. Today one day and two day delivery are normal and same day delivery is possible. On top of near immediate and almost complete hassle-free delivery local retailers must compete against near limitless variety and in many cases a 6-10% government mandated price difference.

In Quill, the US Supreme Court made it clear that a state's ability to employ an effective sales tax was going to depend on the authority granted by Congress under the Commerce Clause. I come before you today to ask you to exercise that authority.

**E-commerce Sales:**
According to the Department of Commerce e-commerce sales in 2005 were $87 billion. This year they will total more than twice that amount. The quarterly e-commerce sales in 2011 increased on average 17% more than the same quarters in 2010, while total sales increased less than 8%. While that difference may seem great, it is actually below normal for e-commerce sales. Prior to this year e-commerce sales increased at a much greater rate than did total sales. If e-commerce sales are increasing at a rate greater than total sales the difference must be sales that would have otherwise gone to a local retailer. Retailers across this country often find themselves acting at the display case for consumers who come in and try out the product but then go home and buy it on-line. The amazing power of mobile phones allows consumers to scan product codes, check prices and buy a product from another business before they even leave the first business.

**Collecting is too complex:**
Some will actually argue that it is impossible to collect. Every retailer today looks to automate everything that can be automated. Sales tax collection software exists, it works and it is

affordable. Computer technology and supply chain management have radically changed retailing. In many ways the Internet is the perfect environment in which to collect sales taxes because sales tax collection can be automated.

**Impact on small business:**
Some opponents will argue against placing another burden on businesses and especially on small business. Unfortunately, today the burden is on those retailers who are trying to compete against someone who isn't collecting the tax. That 6-10% government mandated price advantage is the real burden on small business. However, all of the bills introduced in this Congress protect small businesses by excluding the smallest, by requiring states to simplify their laws and processes, and by requiring states to provide software.

**Collecting is a tax increase:**
Some opponents will tell you these bills are a tax increase. It is not true that paying a tax you owe, but were not paying, is a tax increase. If this theory were taken to its logical extreme every audit assessment would be a tax increase since someone is being forced to pay a tax they hadn't paid. The obligation to pay exists today. Asking one retailer to collect without asking the same of all retailers doesn't seem like equal protection under the law.

**States have not done enough to collect the tax owed today:**
Some opponents will say the states don't do a good enough job collecting the use tax. There are only two ways to collect this tax: have the retailer collect it or educate and then audit consumers. There is nothing more inefficient than conducting an audit and I disagree with those who argue that states should engage in more audits.

**States have not simplified enough:**
Some opponents will say the states have not simplified their tax systems enough to warrant Congressional authority. In 1967 the Supreme Court said that with the various sales tax systems and the very limited technology that then existed was too much to allow states to require everyone to collect. What the Supreme Court didn't answer was how much simpler the sales tax system would have to be and what technology would have to exist to rule differently. Technology has changed in every possible way since 1967. The debate since the Supreme Court's decision is how much simplification must be done, and that is a decision best left to Congress to decide.

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Mr. SMITH. Thank you, Mr. Kenley.
Mr. Misener?

**TESTIMONY OF PAUL MISENER, VICE PRESIDENT OF WORLD-WIDE PUBLIC POLICY, AMAZON.COM, INC.**

Mr. MISENER. Thank you, Chairman Smith and Ranking Member Conyers, for inviting me to testify.

Amazon has long supported an even-handed Federal approach for sales tax collection and to that end we have participated in the Streamlined Sales Tax project for over a decade and we are very pleased to participate in this hearing. Amazon strongly supports enactment of a Federal bill with appropriate provisions.

Mr. Chairman, Congress should authorize the states to require collection with the great objects of protecting states' rights, addressing states' needs and leveling the playing field for all sellers.

Congress should protect the states' rights and authorize them to require collection of sales tax revenue already owed, and doing so would not violate pledges that are limited to questions of income tax rates and deductions.

Congress should help address the states' budget shortfalls without spending Federal funds by authorizing the states to require collection of the billions of revenue dollars already owed.

Congress should not exempt too many sellers from collection, for these sellers will obtain a lasting unlevel playing field versus Main Street and other retailers.

Mr. Chairman, Congress feasibly can authorize the states to require collection. With today's computing and communications technology, widespread collection no longer would be an unconstitutional burden on interstate commerce and Congress feasibly can authorize the states to require all but the very smallest-volume sellers to collect.

Much attention has been paid to the size of a small-seller exception threshold in Federal legislation, and rightfully so. Such a threshold, which would exempt some sellers from a collection requirement, must be kept very low to attain the objection—the objectives of protecting states' rights, addressing the states' needs and creating fairness among sellers.

In this context, several kinds of small volume sellers must be considered. Foremost are the Main Street small-business retailers who, unless the small-seller exception threshold is kept very low, will forever face an unlevel playing field compared to a newly-created exempt class of out-of-state sellers.

Small-volume online sellers have received most of the attention and not without reason. No one wants these sellers to shoulder alone burdens compared to those faced by the small-business retailers who already collect sales tax in our local communities.

Yet, no one should want these online sellers to take advantage of a newly-created unlevel playing field over small Main Street businesses and no one should want government to pick business model winners and losers this way.

The consequences of a threshold's level to states' rights, the states' needs and fairness are very significant because a surprisingly large fraction of e-commerce is conducted by smaller-volume sellers.

For example, nearly 30 percent of uncollected sales tax revenue today is attributable to sellers with annual online sales below $150,000 and only 1 percent of online sellers sell more than this amount.

In other words, a $150,000 exception would deny the states nearly 30 percent of the newly available yet already owed revenue but would exempt from collection 99 percent of online sellers.

Any higher threshold would deny the states even more revenue and keep the playing field even more unlevel.

Fortunately, today's computing and communications technology will allow all—excuse me, all online sellers to collect and remit tax like Main Street retailers. The technology is not limited to large sellers.

Rather, service providers also make the technology available to medium- and small-volume sellers. Thus, collection is either by sellers or for sellers.

There are many such service providers today—ADP, Avalara and FedTax, for example. Two other examples come to mind, Amazon and eBay.

Both companies use sophisticated computing and communications technology to serve their seller customers. But while Amazon is prepared to make its technology available as a service to help sellers by collecting tax for them, eBay seeks to avoid any role in collection, claiming that small-volume sellers will be burdened and implicitly that eBay's technology is not capable of helping its larger sellers to collect.

And these claims are made despite the fact that eBay manages to collect the transaction fees it charges its sellers and despite the fact that eBay already calculates state sales tax for eBay sellers all the way down to the local jurisdiction level.

Amazon and many other service providers will help smaller online sellers collect and, surely, eBay can as well.

In conclusion, Mr. Chairman, Congress may, should and feasibly can attain the objectives of protecting states' rights, addressing the rights—the needs of states without Federal spending and leveling the playing field for all sellers but only if any, quote, "small-seller exception" is kept very low.

The time to act is nigh. Amazon is grateful for this hearing and we look forward to working with you and your colleagues in Congress to pass appropriate legislation as soon as possible.

I look forward to your questions.

[The prepared statement of Mr. Misener follows:]

Hearing on the

Constitutional Limitations on States' Authority to Collect Sales Tax in E-Commerce

Before the

Committee on the Judiciary
United States House of Representatives

November 30, 2011

Testimony of

Paul Misener
Vice President for Global Public Policy
Amazon.com

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Thank you, Chairman Smith and Ranking Member Conyers, for inviting me to testify. Amazon has long supported an even-handed federal framework for state sales tax collection and, to that end, we have participated in the Streamlined Sales Tax Project for over a decade, and we are pleased to participate in this hearing. Amazon strongly supports enactment of a federal bill with appropriate provisions.

Mr. Chairman, Congress – and only Congress – may, should, and feasibly can authorize the states to require out-of-state sellers to collect the sales tax already owed.

At the Philadelphia Convention, which the Founders convened principally to consider the challenging issue of trade among the states, Congress was granted exclusive power to regulate interstate commerce. Exactly two centuries later, in 1987, North Dakota challenged this exclusivity and, following five years of litigation, the U.S. Supreme Court held in *Quill v. North Dakota* that requiring out-of-state sellers to collect tax would impose an unconstitutional burden on interstate commerce. The *Quill* court also confirmed that Congress eventually could "disagree with our conclusions" and that this issue is "not

only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve."

Far from an e-commerce "loophole," the constitutional limitation on states' authority to collect sales tax is at the core of our Nation's founding principles. For this reason, Amazon has steadfastly opposed state attempts to require out-of-state sellers to collect absent congressional authorization.

Mr. Chairman, Congress *should* authorize the states to require collection, with the great objects of protecting states' rights, addressing the states' needs, and leveling the playing field for all sellers.

States' rights should be protected. States need the freedom to make their own revenue policy choices. For example, Texas has chosen to eschew personal income tax, and that decision makes the Texas budget particularly sensitive to uncollected sales tax. The right of Texas to make this policy choice effective should be protected. Congress should protect the states' rights, and authorize them to require collection of sales tax revenue already owed, and doing so would not violate pledges that are limited to questions of income tax rates and deductions.

The states' financial needs should be addressed. The states face serious budget shortfalls, yet the federal government faces its own fiscal challenges. Congress should help address the states' budget shortfalls without spending federal funds, by authorizing the states to require collection of the billions of revenue dollars already owed.

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

Mr. Chairman, Congress feasibly *can* authorize the states to require collection. The facts in the *Quill* decision arose a quarter of a century ago, and the Supreme Court's decision was rendered a year before the World Wide Web was invented. With today's computing and communications technology, widespread collection no longer would be an unconstitutional burden on interstate commerce, and Congress feasibly can authorize the states to require all but the very smallest volume sellers to collect.

Much attention has been paid to the size of a "small seller exception" threshold in federal legislation – and rightfully so. Such a threshold, which would exempt some sellers from a collection requirement, must be kept very low to attain the objectives of protecting states' rights, addressing the states' needs, and creating fairness among sellers.

In this context, several kinds of small volume sellers must be considered.

Foremost are the Main Street small business retailers who, unless the small seller exception threshold is kept very low, will forever face an un-level playing field compared to a newly-created exempt class of out-of-state sellers.

Next are the online advertising affiliates, tens of thousands of whom have lost jobs or income as the result of ineffective, counterproductive sales tax laws recently enacted in a half-dozen states. Congress should act to make such laws uninteresting and irrelevant to the states – and thereby immediately restore the lost jobs and income – by authorizing the states to require collection.

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

The consequences of the threshold level to states' rights, the states' needs, and fairness are very significant, because a surprisingly large fraction of e-commerce is conducted by smaller volume sellers. For example, nearly 30% of uncollected sales tax revenue today is attributable to sellers with annual online sales below $150,000, and only one percent of online sellers sell more than this amount. In other words, a $150,000 exception would deny the states nearly 30% of the newly-available (yet already owed) revenue, but would exempt from collection 99% of online sellers. Any higher threshold would deny the states even more revenue and keep the playing field even more un-level.

Fortunately, today's computing and communications technology will allow all online sellers to collect and remit tax like Main Street retailers.

Large volume online sellers already have and use this technology. Amazon and Overstock, for example, collect tax on sales to consumers in states where our retail businesses have nexus. And the online arms of large multichannel retailers collect in the states where they have retail stores. Quite obviously, state sales tax can be collected nationwide, at least by larger volume sellers like Amazon, Overstock, and the multichannel stores, for they have the technology.

This technology is not limited to large sellers. Rather, service providers also make the technology available to medium and small volume sellers. Thus, collection is either *by* sellers or *for* sellers. There are many service providers already: ADP, Avalara, and FedTax, for example.

Two other examples come to mind: Amazon and eBay.

Both companies use sophisticated computing and communications technology to serve their seller customers. But, while Amazon is prepared to make its technology available as a service to help sellers by collecting sales tax for them, eBay seeks to avoid any role in collection, claiming that small volume sellers will be burdened and, implicitly, that eBay's technology is not capable of helping its largest sellers to collect. And these claims are made despite the fact that eBay manages to collect the transaction fees it charges its sellers, and despite the fact that eBay already calculates state sales tax for eBay sellers, all the way down to the local jurisdiction level. Amazon and many other service providers will help smaller online sellers collect; surely eBay can as well.

In conclusion, Mr. Chairman, Congress may, should, and feasibly can attain the objectives of protecting states' rights, addressing the states' needs without federal spending, and leveling the playing field for all sellers – but only if any "small seller exception" is kept very low.

The time to act is nigh. Amazon is grateful for this hearing, and we look forward to working with you and your colleagues in Congress to pass appropriate legislation as soon as possible.

Thank you. I look forward to your questions.

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Mr. SMITH. Thank you, Mr. Misener.

Let me recognize myself for questions and let me address my first question to Mr. Byrne and Mr. Cohen, and it is this.

If states already have the authority to collect sales tax from remote sellers, why shouldn't they also have the means to collect sales taxes from the remote sellers?

Mr. BYRNE. Thank you——

Mr. SMITH. Go on, Mr. Byrne, first, if you will.

Mr. BYRNE. Mr. Chairman, the *Quill* decision establishes that it would be that the states can go up to a certain line and no further, and that line is drawn by the Supreme Court at——

Mr. SMITH. But Congress could change that line and in fact the Supreme Court almost invited us to, didn't it?

Mr. BYRNE. No question, and they did. No question you have the power to. No question that per the *Quill* decision you have the power to change it.

Mr. SMITH. Again, if states can collect it why shouldn't they have the means to collect it?

Mr. BYRNE. I am sorry, sir?

Mr. SMITH. If states have the authority to collect a sales tax from remote sellers, why shouldn't they also be given the means to do so?

Mr. BYRNE. Well, so states have the authority—actually, the U.S. Congress has the authority to empower the states to but they shouldn't because at this point it is—what it is really going to be about is Amazon and the big-box—big-box retailers having a way to draw the drawbridge up after them.

It is very burdensome and it will be very burdensome for companies like mine to establish databases or plug in to databases and keep—charge appropriate taxes on every kind of product in 10,000 jurisdictions.

Mr. SMITH. Okay.

Mr. BYRNE. You know, in some—in some jurisdiction candy is taxed like a candy and some is taxed like food, a gift basket. It will be extraordinarily complex for us to implement.

Mr. SMITH. Okay. Thank you.

Mr. Cohen?

Mr. COHEN. Well, Mr. Chairman, we agree that not only do you have the power but the means should be provided to the states. It is just a question of small business and small-business protection that we believe is where the issue lies, not whether the states have the—should be given the right and the means to collect.

Mr. SMITH. Okay. Thank you, Mr. Cohen.

Mr. Misener, which of the three bills under consideration would you support?

Mr. MISENER. Well, I think there has been—there have been three breakthroughs this year, Mr. Chairman. The first breakthrough was when Mr. Conyers and his colleague, Senator Durbin, introduced a bill in July which gave to the Governing Board of the Streamlined Sales Tax Project the right to decide the correct threshold for a small-seller exception.

The next breakthrough is Mr. Womack's bill, which recognized that not all states will be able to make the changes required by Streamlined. And the third breakthrough was the Senate bill introduced a few weeks ago which would——

Mr. SMITH. Would you—would you support any of those breakthroughs?

Mr. MISENER. Yes, sir. All three.

Mr. SMITH. All of them?

Mr. MISENER. All three.

Mr. SMITH. Would you? Okay.

Mr. MISENER. We were concerned about the size of the small-seller carve-out in Mr. Womack's bill but we believe that that is a subject for discussion here today.

Mr. SMITH. Okay. Okay. Thank you, Mr. Misener.

Mr. Marshall, Mr. Otto and Mr. Kenley, if we were to enable states to collect a sales tax from remote sellers, wouldn't that increase the cost of merchandise to consumers? And if so, is that justified or not justified? Mr. Marshall?

Mr. MARSHALL. Well, I don't—I certainly can't speak as an expert on that topic but my understanding is that sales tax is or use tax is owed by Michigan residents on all their purchases.

So it is not a new tax. It is simply leveling the playing field as it relates to who is required to collect it and who is required to voluntarily disclose it in their tax return.

Mr. SMITH. Right. That was my point. They had the authority and they can impose a tax. It is just right now most states do not actually collect it. But that is my—Mr. Otto?

Mr. OTTO. I would agree with what he says.

Here is one interesting point, though. If you are a business and you hold a sales tax permit in the state of Texas, you go through audit you are going to be found if you have not remitted use tax you should have.

So in those instances, there is some. But in Texas we have no way for a household to remit use tax. There is no state income tax. There is no form for anybody to remit the use tax.

Mr. SMITH. So you are saying the taxes are owed anyway, they might as well be collected?

Mr. OTTO. They are owed.

Mr. SMITH. Okay. Mr. Kenley?

Mr. KENLEY. Thank you, Mr. Chairman.

My perspective is that the only disparity in the competitive world that we have today in this arena is the 6 to 10 percent sales tax that is being imposed on some retailers and not on others.

I think if you eliminate that and level the playing field, I think you are going to see more competition. So I don't think the consumer is necessarily going to suffer in that—in that situation, Mr. Chairman.

Mr. CHAIRMAN. Okay. Thank you, Mr. Kenley.

The gentleman from Michigan, Mr. Conyers, is recognized for his questions.

Mr. CONYERS. Thank you, Chairman Smith, and I want to thank the witnesses for their individual contributions to this subject.

Now that we have established that *Quill* gives us the authority, as a matter of fact we are encouraged to take some action in this, I think the question really is how do we do it as fairly as we can.

Now, ironically, as our witness, Mr. Marshall, has pointed out, there is already a tax on Internet transactions but nobody is paying it any attention.

Am I correct that Michigan is in that posture, Mr. Marshall?

Mr. MARSHALL. Yes, you are. We are required to report our Internet sales, purchases and pay—remit a use tax on that. But there is just no way for the state of Michigan to know what transactions are occurring.

Mr. CONYERS. I wonder how many other states are like that. Does anybody know how many states might be in the same position that the state of Michigan is in? Namely, that there is a tax already existing and that, by the way, there is a 6 percent sales tax in Michigan and there should be a Internet tax and it is being ignored.

So couldn't someone argue, Mr. Marshall, that we don't need to do anything, just if everyone followed the law we would be better off? What do you say to that?

Mr. MARSHALL. Well, I just think collection ought to be uniform. If some retailers are required to collect then all retailers should be required to collect. I think it is just the unfairness of some of us being required by law to collect sales tax and other retailers that are selling product in our state are not.

Mr. CONYERS. Well, suppose we passed a law and everybody did what Michigan does is ignore it. What would you say to that?

Mr. COHEN. Mr. Conyers, the current law in the 45 states that have sales tax plus the District of Columbia is that there is a concurrent use tax obligation for a purchaser who does not pay the sales tax when they purchase the item. Some states, like Texas, don't have a way in which that can be remitted.

Other states, like California, have a line on the income taxes, state income taxes, for use tax collection. It is done. It is the law.

It is very difficult and I do respect the tax collection efforts by many states that it is very hard to do and it will cost a significant amount of money to do that, and therefore it does seem to make a lot more sense that on large retailers you impose a burden that they collect and remit sales taxes across all 45 states.

Mr. CONYERS. So you support my legislation?

Mr. COHEN. As currently written, we do not support the legislation, Mr. Conyers.

Mr. CONYERS. Well, that——

Mr. COHEN. Because of the lack of a sufficiently high small-business exemption.

Mr. CONYERS. So that is your main reservation about it?

Mr. COHEN. Yes, sir.

Mr. CONYERS. Well, let me ask you this. Is it fair for some witnesses—some businesses to have a sales tax advantage by not having to collect sales taxes, which is why you are for this bill if we could get that small-business exception straightened out.

Mr. COHEN. Yes, sir. And let me quote Jeff Bezos from 1996: "In the mail order business, you have to charge sales tax to customers who live in any state where you have a business presence. We thought about the Bay Area, which is the single best source for technical talent, but it didn't pass the small state test."

So there was an advantage that he chose for his company to place it in Washington State to take advantage of the distant state sales tax exclusion.

Mr. CONYERS. Thank you very much.

Mr. MISENER. If I may, since my CEO was just mentioned, I think we have to recognize something here that that choice was made under current law. What we are proposing today is to change the current law. Congress has this authority very clearly.

Let's recall, of course, that eBay has facilities in 20 states around the country. They have fulfillment centers in eight states around the country. It is not a isolated business, as they would suggest.

They also, of course, are a multi-billion-dollar company. Sales through eBay exceed Amazon's retail sales. So doing something to carve out eBay from collection will have significant ramifications to the states and for fairness.

Mr. CONYERS. Mr. Chairman, could I ask my friend here if he has any rebuttal comment to that statement?

Mr. COHEN. If eBay was a retailer, of course, eBay, where it had physical presence, would have an obligation to collect and remit sales taxes in those states. But eBay is not a retailer.

eBay is a marketplace in which people offer items for sale and are the sellers, and the sellers have the obligations. And one of the things we are quite proud of is that our sellers that are in the 45 states and the District of Columbia that remit and owe sales taxes collect and remit them.

Mr. CONYERS. Yeah.

Mr. COHEN. So our small sellers, including Mr. Marshall, pays his sales tax in Michigan for his sales in the state of Michigan online. Amazon——

Mr. CONYERS. Mr. Chairman, could I get a rebuttal to the rebuttal, please?

Mr. SMITH. The gentleman from Michigan is recognized for an additional minute.

Mr. MISENER. Yes, sir. Thank you very much, both of you.

Amazon also has a platform for sellers and we have over 2 million sellers that sell through our sites. We will make a service of tax collection or remittance available to our sellers. We only ask that eBay do the same.

Mr. SMITH. Thank you, Mr. Conyers.

The gentleman from North Carolina, Mr. Coble, is recognized.

Mr. COBLE. Thank you, Mr. Chairman.

Gentlemen, good to have you all with us today. Mr. Otto, the Committee—this Committee recently passed H.R. 1439, the Business Activity Tax Simplification Act, which confirms *Quill*'s physical presence standard for collection of corporate income and other business activity taxes.

Would your bill apply just—the nexus just for the sales tax or would it reach into other business taxes as well?

Mr. OTTO. No. It is my understanding that all we are dealing with here is sales and use tax. We are not trying to change nexus statutes for any other tax.

Mr. COBLE. That was my thinking. I wanted to hear it from you to be sure. What do you believe, Mr. Otto, is an appropriate small-seller exemption threshold?

Mr. OTTO. Well, you are asking me to get into a battle I am not sure I am willing to get into. [Laughter.]

Without looking—I mean, I am only familiar with my state. Without looking, and you are talking about a bill here that is going to affect 45 states and the District of Columbia, that is something I understand from the testimony that has been given here today that is going to be an important issue.

I don't have a preconceived idea. I can't pick a number out of the air and tell you this should be the small-business exemption. I think it is going to require some study on this Committee's part in order to come up with what is fair. I do support a small-business exemption. It is just in defining what is small business.

Mr. COBLE. I didn't intend to have you to put your oars into troublesome waters, Mr. Otto.

Mr. Misener, I am getting involved in some hearsay evidence here. Last week, a constituent of mine told me that he heard on the radio an ad for Blinds.com. The gist, he tells me, was that they—was to buy blinds from Blinds.com because there is no sales tax in most states.

Is it true, in fact, that there is no sales tax in most states for Internet sales, and if so, would you agree that that could very well present a competitive edge over the Brick and Mortar sellers?

Mr. MISENER. Thank you, Mr. Coble.

We collect—in the four states where our retail business has a physical presence we already do that. What we are seeking today is congressional legislation that would authorize the states to require all out-of-state sellers including Amazon and Blinds.com to collect regardless of whether their retail business has a physical presence in a state.

Mr. COBLE. Mr. Bryne—where is Mr. Bryne? I don't see Mr. Bryne. Byrne—Mr. Byrne.

Mr. BYRNE. I am sorry.

Mr. COBLE. Mr. Byrne, Brick and Mortar retailers characterize the Marketplace Equity Act as restoring fairness to the retail industry. How do you respond to that?

Mr. BYRNE. I would say that there is—it cuts both ways. Brick and Mortars also have advantages over us. They get to—over Internet companies. They get to interact directly. They get to hand over the goods immediately. Customers get to, you know, touch them before they buy them. They can return them right there.

So there is—so there is advantages and disadvantages that cut both ways. We wouldn't—we wouldn't come and say gee, Congress has to do something in order to level the playing field on Brick and Mortars to take away those advantages. So I will stop there.

Mr. COBLE. Mr. Cohen, advocates of sales tax reform legislation insist that technology can easily calculate and collect sales tax—taxes at the destination rate. If this be the case, what would be the burden on eBay's small-business customers if such technology were made available to them?

Mr. COHEN. Mr. Coble, we have been very clear for at least the 11 years I have been working with the company that this is not a technologically difficult thing to accomplish. It is burdensome.

It is a morass of many, many different state laws with 9,647 different taxing jurisdictions. But that does not make it impossible for people to collect and remit.

Our basic point of view is that it would be much more fair if all small businesses were to receive the same fairness that a large retailer were to get—lower shipping costs, economies of scale—and that this is a place in which tax policy can be used to make sure that small businesses have an opportunity to participate in the global market.

Mr. COBLE. I got you. Thank you, sir.

Mr. Chairman, I am going to try to beat that red light before it illuminates by putting a question to Mr. Misener.

How have states' affiliate nexus statutes affected your business and how does Amazon use affiliates? What toll has the ensuing litigation had on your—on your operation?

Mr. MISENER. Thank you, Mr. Coble.

Affiliates are small websites within states around the country, around the world that place links on their site to a variety of retailers including Amazon, and when a consumer clicks on that link and ends up buying something at the retailer, the website gets a commission.

It is a great advertising model. It is a great business model. A lot of small businesses have benefited. There have been counterproductive bills enacted around the country—I think a half dozen now—where states have tried to describe those advertising activities as giving an out-of-state retailer nexus.

We completely reject it but at the same time these laws have passed and so we simply have stopped advertising. It is unfortunate.

We certainly wish we could get those advertisers back, and in North Carolina included we would love to be able to welcome back our Amazon.com associates and we would do so when Federal legislation is enacted.

Mr. COBLE. I thank you. Mr. Chairman, I lost the race with the red light. I yield back.

Mr. SMITH. Thank you, Mr. Coble.

The gentleman from Virginia, Mr. Scott, is recognized.

Mr. SCOTT. Thank you, Mr. Chairman.

I yield to the gentleman from Michigan.

Mr. CONYERS. Thanks, Mr. Scott.

I just want to ask Mr. Misener, who represents Amazon, you are one of the big guys but yet you are supporting a fair tax, a balanced tax, with the little guys like Marshall.

Is there some explanation for your extraordinary good moral bearing that you bring to this hearing today?

Mr. MISENER. Well, personally, it is worthy of question with me but we have long supported Federal legislation. In fact, we made this decision right after I joined the company a dozen years ago.

At the time we faced a choice. Could we draft off of the Internet Tax Freedom Act moratorium and somehow claim that the Internet deserved a privileged non-tax position. We have never taken that position.

We have participated constructively in the Streamlined Sales Tax Project as a way to work with the states to get the—eventually get to the point of Federal legislation. The three breakthroughs that I mentioned this year starting with your—with your bill in July really, I think, are breaking the logjam.

So we are to the point of actually recognizing the fruits of our labor all these years.

Mr. CONYERS. Let the record show that there are corporate good guys in this world. Thanks, Mr. Scott.

Mr. SCOTT. Thank you.

Senator Kenley, if somebody in Washington, D.C., goes to a Brick and Mortar store in Virginia and buys something, do they pay the Virginia sales tax?

Mr. KENLEY. If they go to the Virginia store they do and the basis of the tax is on the destination—in other words, where the transaction takes place, and it is normally where the consumer is.

Mr. SCOTT. And if the Virginia store delivered it in Washington, D.C., a washing machine, for example, where would—who would pay the tax?

Mr. KENLEY. Well, we spend a lot of hours arguing those points in Streamlined and we have refined that so that in some cases it would be in Washington, D.C., where the sales takes place and in some places it could be in Virginia.

Mr. SCOTT. Well, if the sale took place in Virginia and they delivered the washing machine to the residents in D.C.——

Mr. KENLEY. Okay. If they deliver it, it is taxable in Washington, D.C.

Mr. SCOTT. Okay. Now, are you aware—is there any small-business exemption to the local sales tax?

Mr. KENLEY. No, not in—I don't think there is in any of the states. Everybody is on the level playing field there.

Mr. SCOTT. If the tax is due but not collected by the business, do you have an estimate of how often it is actually collected, some kind of way?

Mr. KENLEY. You mean how often it is paid through the use tax system?

Mr. SCOTT. Right.

Mr. KENLEY. In Indiana, we have less than 1 percent of our filers who actually fill out a use tax return and remit a use tax based on remote purchases.

Mr. SCOTT. If the business were to actually collect the tax, what would they do with the money? How would they get it to the various states and localities?

Mr. KENLEY. Well, the service—first off, the small business can use a certified service provider and we actually have one small business in New Hampshire of less than $50,000 in sales that signed up for this in 18 minutes and that is all it took, and they are not charged anything to be a participant, and the certified service provider—the retailer collects the tax when they bill the customer.

They then turn it over to the service provider. They fill out all the returns necessary in the 45 states that have sales tax and remit it appropriately in a very seamless proposition.

Mr. SCOTT. Now, who pays for that service?

Mr. KENLEY. The states pay for it and then the certified service providers take the amount of compensation that Streamlined offers or that those states offered in addition to the regular compensation package.

Mr. SCOTT. Now, is that service actually available to everybody now?

Mr. KENLEY. Yes. We have six certified service providers who can do this. Many of the larger companies have chosen to just implement their own system, and Amazon has developed a system where

they are a certified service provider for their retailers that participate on their platform.

Mr. SCOTT. Does that include the—some localities have a local sales tax.

Mr. KENLEY. That is correct. It includes all of those jurisdictions with local sales tax as well, no problem.

Mr. SCOTT. And so a small business can sign up for the service, no cost——

Mr. KENLEY. That's right.

Mr. SCOTT. Assess the tax. Do you have some software to tell them how much to charge?

Mr. KENLEY. No cost on the software.

Mr. SCOTT. So the software tells them how much to charge so they add it to the bill. They collect it and then they send in the aggregate amount collected to some service who will distribute the money——

Mr. KENLEY. To the—right.

Mr. SCOTT. At no cost.

Mr. KENLEY. That is right.

Mr. SCOTT. Thank you, Mr. Chairman.

Mr. SMITH. Thank you, Mr. Scott.

The gentleman from Indiana, Mr. Pence, is recognized.

Mr. PENCE. Thank you, Chairman.

Thanks for holding this hearing and I am grateful for the testimony of all the participants but I particularly want to acknowledge not only Senator Kenley that I had the opportunity to introduce, who is a leader in Indiana, a man I greatly admire but also I want to appreciate two other of the witnesses.

Mr. Misener with Amazon—Amazon is a great corporate citizen in Indiana and we are—appreciate the tone and tenor of your testimony and your remarks today.

And I also want to acknowledge Mr. Byrne, who I have had the pleasure to meet because of his association with education reform at the Milton and Rose Friedman Foundation that is proudly located in Indianapolis, Indiana. So this is a distinguished panel, to say the least.

I find this discussion enormously helpful, Mr. Chairman. It is—it is clear that since the advent of not the *Quill* decision but the Commerce Clause itself that under our form of government we have—the Congress has essentially granted exclusive power to regulate interstate commerce at the national level.

I have, as you know, Mr. Chairman, and other Members on this end of this Committee I have long opposed taxing the Internet. I greatly associate myself with comments that were made about the extraordinary innovation that has occurred in e-commerce in this country and I believe it represents a bulwark of American prosperity in the last 20 years.

I believe the moratorium on Internet taxation has been prudent and I have strongly supported it. It does strike me, though, that as this marketplace has matured that there is an argument as has been made eloquently by several on the panel for us to consider letting states decide.

But it—but it strikes me that we ought to follow—at least this conservative is committed to following a couple basic principles.

Number one is no new taxes. My colleague from Texas and I, I feel instinctively share a particular view of taxes. Maybe I am presuming but I—we ought to make sure there is no new taxes on the people of the several states.

Secondly, I do—I do acknowledge that there ought to be no undue burden on commerce, particularly e-commerce in this case. I am also very interested in the—in what would be the recommendation of members of the panel about the proper small-business exemption.

I think the two large principles here for me is I don't think Congress should be in the business of picking winners and losers, and inaction by Congress today results in a system that does pick winners and losers.

I also—I am a very strong advocate of federalism, as you are, Mr. Chairman, and it is my judgment that having Congress continue to stand in the way of letting states decide if we can meet these other criteria is worthy of our deliberations here as we preserve and promote and seek to invigorate the principles and the practice of federalism across this country.

Let me ask this question, though. I will direct this to Senator Kenley in the time that is remaining, that we just heard Mr. Coble speak about a Blinds.com radio ad, the tagline of which—well, I will just quote him and paraphrase him, I don't accuse the company of any particular distortion—but we have all heard ads like this, saying that in most states no sales tax. There is no sales tax on Internet sales.

Let me ask you, Senator Kenley, as—in a point of fact is it that there is no sales tax on Internet sales or is it simply that states do not have the authority to collect taxes that are owed?

Because this, to me, is a very—in our very first conversation about this, Senator Kenley, you know, I am someone who believes if you owe taxes pay taxes. But maybe you can address that. Is it—what is the situation in America today, first, in Indiana and all over the country?

Is there no sales tax on Internet sales or is there in fact a sales tax, it just simply—Indiana and other states do not have the ability or capacity to collect it under the law?

Mr. KENLEY. Thank you for the question, Congressman Pence.

First off, I would say that this is not a tax on the Internet. This is a tax on the consumer who is going to receive the government services that are provided in whatever state that is.

As to your question about whether or not there is a tax or whether the tax is collected, we have noticeably been unable to collect the tax other than by having the retailer remit, and so that is why we have gone to these great lengths to make it cost effective or cost free, particularly for small retailers, to be able to have a collection and remission process.

If we didn't do this, I am afraid we would end up like Greece and nobody would pay their taxes. But—and we don't want to go there. So it has just been a difficult proposition to work it out.

I think once you start down other paths of trying to find ways to collect that use tax, which is already due and owed, then you get into things that you are trying to get information about consumers, are you participating in invasion of privacy, are we using

the heavy hand of government and the tax collector to beat on people unduly.

And the sales tax system, which historically has been, as Mr. Marshall states, that the retailer collects and remits the tax, that is the historical precedent and we could make that work in this system due to the advances in technology even since the Internet age of commerce started.

Mr. PENCE. But the tax under Indiana law, and I will only ask you this, the tax is owed.

Mr. KENLEY. The tax is owed.

Mr. PENCE. It is owed by the consumer.

Mr. KENLEY. It is owed in all 45 states. They all have the same situation in that regard.

Mr. PENCE. Thank you.

Thank you, Chairman.

Mr. SMITH. Thank you, Mr. Pence.

On the way to recognizing the gentlewoman from California, I would like to recognize Congresswoman Jackie Speier who, along with Congressman Womack, is a sponsor of the Marketplace Equity Act and who has just come into the room. Does she—there she is. Okay. Good.

The gentlewoman from California, Ms. Lofgren, is recognized.

Ms. LOFGREN. Well, thank you, Mr. Chairman, and for this useful and interesting panel. I didn't have the chance to introduce Mr. Cohen but eBay is actually headquartered in San Jose. So welcome, San Jose-based eBay.

You know, one of the things that I am listening here is to try and identify we want to stand with the little guys because small businesses are the engine for the American economy. They are the ones that are creating the jobs and the difficulty is who is that.

You know, who is standing up for the little guys, and I guess the question I have for you, Mr. Cohen, is I know eBay is an entity but you don't sell stuff. I mean, it is your—it is a platform and people are selling.

When I go on eBay, it looks like it is mainly small guys. When I go on Amazon, which I do a lot and thank you for having your service, especially when we are in Washington and Christmas is coming up, you know, sometimes there are small guys, like especially for specialty books, but it is mainly larger retailers that you get to through your site.

What percentage of eBay's users are what you would consider small business and how would you define that, Mr. Cohen? And then I would like to ask the same question of the Amazon witness.

Mr. COHEN. Congressman Lofgren, for many of our sellers eBay is only one channel that they use. So whatever statistics we know of their use of our platform, like Mr. Marshall, eBay is one part of his business.

Ms. LOFGREN. I see.

Mr. COHEN. He has a significant portion of his business, a much larger portion of his business, in the state of Michigan.

What is important, though, what we believe is important is how do you define what the size of a small business should be to take advantage of an exemption, and we have recommended and en-

dorsed bills that have included the Small Business Administration's determination of what is an electronic retailer.

That is what determines whether a small business qualifies for SBA loans and other assistance, and the number, which is reset annually to determine what is the appropriate size, the last year was approximately $30 million in distance sales. That is what we would——

Ms. LOFGREN. Now, that sounds like a lot but for—that is gross, correct? What would that usually—if you had that kind of gross sales what would that really net you as a business, ordinarily?

Mr. COHEN. Well, if you live in the state of Texas, where they don't have a personal income tax, it may make a lot more money than in the state of California or in other states.

But our general impression is that most of those sellers, even up to a $30 million in sales, are having very, very tiny margins and that what they are making and netting out from that is significantly less than what their large retailer competitors can be.

For one example, our estimate is that $30 million number we believe that would be the amount of sales on Amazon since the beginning of this hearing today.

Mr. MISENER. Thank you, Ms. Lofgren.

First of all, on Mr. Cohen's Small Business Administration number, we just need to debunk that right from the start. It has absolutely nothing to do with the conversation today which is about burden on small businesses for collecting sales tax.

It has everything to do about set-asides for small business in government contracting context. Absolutely nothing to do with remote sale collection.

Mr. Cohen's company has told Wall Street, at least, that they have something over 25 million sellers. I assume that is a worldwide number so, forgivingly, that is probably about 10 million domestically. We have analyzed it with just as few as 5 million sellers so really cutting off a large part of the long tail that exists. Analyzing at $5 million, only 1 percent of those sellers sell more than $150,000——

Ms. LOFGREN. But my question to you was what percentage of your sellers are small businesses as compared to big, you know, larger retailers?

Mr. MISENER. Yeah. Our retail business, which clearly is not a small seller, is still the bulk of the sales at Amazon.com. We have only 2 million sellers, additional sellers, the vast majority of which are small. But that pales in comparison——

Ms. LOFGREN. But that is a number. In terms of dollar amount, I mean——

Mr. MISENER. We don't——

Ms. LOFGREN. A little book seller—I sometimes get my husband the books. I mean, they are not doing big volumes, it doesn't look like, in terms of money.

Mr. MISENER. Yeah. I am sorry. We have not released that amount in our SEC filings. But just for scaling it, it is important to recognize that the sales through eBay still exceed the sales by Amazon retail and the number of small sellers at eBay is many times as——

Ms. LOFGREN. Well, that is really not—that doesn't tell us anything.

Let me ask you this, Mr. Cohen. If we did not have an exemption for small businesses, what would the impact be? I mean, you have got small businesses all over the United States, people that are actually supporting themselves in these tough economic times by having, you know, helping to sell stuff, I mean, including Mr. Marshall.

What would the impact be, do you think, on those small businesses across the country?

Mr. COHEN. Without a robust small-business exemption you put an artificial limit on the size and impose the costs immediately upon those people, and we think that the cost on the economy would be fairly significant.

There is an enormous amount of income generated by the eBay platform, by the use of ad words through Google for many different small businesses through the Amazon marketplace to have an opportunity to compete on a global marketplace.

So we think our estimate is that there would be significant job losses with low small-business exemptions.

Ms. LOFGREN. My time is up, Mr. Chairman. I thank you and thanks to the panel.

Mr. GOODLATTE [presiding]. I thank the gentlewoman and the Chair is now pleased to recognize the gentleman from Utah, Mr. Chaffetz, for 5 minutes.

Mr. CHAFFETZ. And thank you. This has been a great discussion. I appreciate the panel and all of your participation.

Does everybody agree there should be some exemption for small business or is anybody advocating that there—we should actually get to be at zero?

Mr. KENLEY. The Streamlined organization in their plan has a $500,000 small-business exemption. Speaking for myself as a retailer, I think that the—there should be no small-seller exemption and I say that because the minute you give a small-seller exemption to the Internet retailer you are then discriminating against the small-seller of the Bricks and Mortar type.

Mr. CHAFFETZ. Okay, but everybody else is agreeing that—in my mind, one of the big questions is what should be that threshold.

Mr. KENLEY. Right.

Mr. CHAFFETZ. What is the threshold by which small—what is a small business and what threshold should it be?

Mr. Byrne, I would like to start with you, if I could. Let's talk about the difference in the modeling and how that affects what you are doing, what eBay is doing, what Amazon is doing and what advantages, disadvantages.

I mean, we are really trying to empower small businesses in this country. Some may say oh, you get an advantage but the others say it is a terrible burden when you are trying to start a new business or supplement your income and do it part time.

Can you just go a little bit deeper into that, please?

Mr. BYRNE. Yes. Sure. In the bill as we have proposed the small-business exemption is up to $20 million. I think that may be the highest of any proposed cap. But as far as the models, if I understood your question correctly, what is really going on is this.

If we open a warehouse in Indiana, as we did once, we interpret the law to be that we have to pay taxes in Indiana.

My fine competitor down at the end of the table, Amazon, they have done—taken a much more aggressive tax position historically where they open a new warehouse in a state, they put it in as a subsidiary and they say oh, you see, we don't own that warehouse, we just own a subsidiary which owns the warehouse. So we don't owe taxes.

They have been doing that from the beginning. Our tax accountants would never let me try something so aggressive. What has happened is the ground is dissolving under their feet on that position and so now they are jumping on this, which is really giving the sleeves out of their vest because Amazon is essentially turning into a big-box retailer, not in the sense of having storefronts everywhere but in the sense of having warehouses.

Mr. CHAFFETZ. Mr. Misener, how many distribution centers do you have across the country?

Mr. MISENER. A couple dozen.

Mr. CHAFFETZ. A couple dozen?

Mr. MISENER. Yes, sir.

Mr. CHAFFETZ. And do you pay taxes on those or don't pay taxes on it?

Mr. MISENER. It is not a tax on Amazon that we are talking about. It is a collection responsibility.

Mr. CHAFFETZ. Right.

Mr. MISENER. We collect where we are legally required, which is in the four states where we have a retail presence.

Mr. CHAFFETZ. I know you—I mean, you got a nice compliment shout-out from Mr. Conyers there but you have also taken a fairly aggressive tax position in saying well, we have no physical presence because it is supposedly—but it is under your control, is it not?

Mr. MISENER. No. These are separate corporations. I don't think anybody on this Committee want to start——

Mr. CHAFFETZ. Let me go back to Mr.—let me go back to—my time is real short. Let me go back to Mr. Byrne here.

Finish that thought. I interrupted you.

Mr. BYRNE. You see my point.

Mr. CHAFFETZ. Yes.

Mr. BYRNE. You see my point. Okay. So because—but that ground is eroding from beneath their feet so they are looking more and more like a big-box and therefore they are jumping on, well—they are jumping on let's get this tax reform. But it is the sleeves out of the vest.

All this tax reform is sleeves out of the vest for big-boxes because they already have—they already have nexus everywhere. So there is—so they are already charging tax anywhere so—everywhere so they don't have to pay any new tax through this, and Amazon is in exactly the same boat.

Mr. CHAFFETZ. Mr. Cohen, let's—eBay is so pervasive everywhere. We are talking about the exemption threshold.

Where do you see that line? I happen to think it should be higher rather than lower but where—what number do you like and what is your perspective on it?

Mr. COHEN. Mr. Chaffetz, we do support the Small Business Administration's calculation for the size of small businesses but we are also open to a discussion that makes it relevant to trying to determine what the appropriate level is.

But our general viewpoint is that if a small business qualifies to obtain loans or if it qualifies as a small business by the people that we entrust to determine the size of small businesses, that it makes a lot more sense than handing the power over to the tax collector who has an interest in trying to maximize every single possible dollar and does not have any interest whatsoever in determining how you create more jobs.

Mr. CHAFFETZ. What is that threshold number? I forget.

Mr. COHEN. Thirty-one—it is approximately $31 million right now.*

Mr. CHAFFETZ. Okay. Thanks to the Chairman. I yield back.

Mr. GOODLATTE. I thank the gentleman.

The Chair recognizes the gentlewoman from Texas, Ms. Jackson Lee, for 5 minutes.

Ms. JACKSON LEE. Mr. Chairman, thank you very much and let me thank a number of Members who have legislative initiatives including—certainly all are my friend but my dear friend and the Ranking Member, Mr. Conyers. And I think it generates or it speaks to the emerging reconsideration of where we are today in 2011 as where we might have been a decade ago or 15 years ago and I believe this issue was before this Committee.

I am delighted to see my colleague from the state of Texas and listen to testimony. So I—let me just show my cards. I think compromise and the recognition of changing times is vital, and all of us have heard the refrain of creating jobs.

Jobs can be created, maybe, if you are a small business and you are using online sales and maybe you have one or two persons in your home or one or two persons in their homes working with you and we don't want to disrespect that level of jobs.

But we also know that the idea of building Bricks and Mortar, persons working in a place, creates a stream of jobs—those who are building, those who pave the parking lot, those who have worked on the roads to get you to the location and, certainly, those who work in the facility, and maybe if we had a number of Black Fridays you would have people working the midnight shift in retail.

So I have to be very concerned about how we bring about this balance and I want to go to my friend from Texas, Representative Otto, and tell me, frame for me, that story you were saying about your town and stores and how much of a difference that makes.

I would then like to follow up with Mr. Misener, excuse me, who has a little twist on this issue. You are the famous Amazon with all of its attractiveness but I hope that you are also in the realistic world that can help us be part of the solution.

Let me go to Mr.—Representative Otto at this time.

Mr. OTTO. Thank you, Congresswoman. The—thank you.

It is estimated currently in the state of Texas that there is between $600 million and $800 million a year in sales and use tax

*Mr. Cohen changed this figure to $30 million.

that is not collected on out-of-state sales. That is a tremendous amount of money.

That points out to me the unfair competition that my storefronts are competing with. If I am a retailer going into business, certainly I am going to take advantage of the Internet and selling over the Internet. No one here is discouraging that. No one here is wanting to tax the Internet.

But in leveling the playing field to make sure that my local stores will continue to be developed, you know, my concern is are we migrating to an economy, and it appears that way if you look at the growth. Not where we are in total dollars but if you look at where the growth is, the growth is definitely to entice people to go to the Internet.

Anybody that thinks they are not going to take an 8 to 10 percent discount into consideration on a big-ticket item such as a camera or something or a computer or a television set, I just don't believe that.

Ms. JACKSON LEE. Let me, because my time is short—you have eloquently stated that. Speak quickly to the issue of it is too complex if you begin to tax, and my point would be we have migrated or moved to a level of technology that it is probably less complex than it might have been 10 or 15 years ago.

Mr. OTTO. All of the bills, as I understand, that are before Congress right now call for the very simplification. For example, if we take H.R. 3179 and allow states to do a states-only, you could end up with as few as 25 jurisdictions because Streamlined has got 24 already in one.

There is 21 states not in Streamlined that have a sales tax and all of these provide that the states have to provide the software if they are going to get down to the local area.

Ms. JACKSON LEE. One quick question and then I would like the gentleman from Amazon. It would probably be unfair competition if we left—I know there is an opt-in scenario but if we left some states out I think we are at a point now where we need to look at whether or not all 50 states need to be under that umbrella.

Mr. OTTO. I agree. I think that whatever is passed it needs to be made available not only to the compact states but the other states as well that will comply.

Ms. JACKSON LEE. Thank you, sir.

Mr. Misener, thank you.

The question is you are the mother of all. What could you live with, and as you look at this legislation do you see the complexity of trying to deal with helping communities, taxation for education and the online marketplace?

Mr. MISENER. Yes, ma'am, Ms. Jackson Lee. We want——

Ms. JACKSON LEE. And you have compacts with New York and California.

Mr. MISENER. Yes. What we are trying to do here is to get Congress to authorize all the sales tax state to require out-of-state sellers like Amazon to collect.

We believe it is imminently feasible. We have come out in strong support of a bill that has a $500,000 small-business exception in it.

It seems very reasonable to us. We wanted one much lower. We really think that if 1 percent is at $150,000 we are talking about a fraction of 1 percent of online sellers would be required to collect under a $500,000 exception. That seems to be a decent compromise to us.

Ms. JACKSON LEE. So your issue is to make it all the states in a compact and you believe that there can be a system, a technology system, that would not be complex to collect those taxes for the states. Is that what you are saying?

Mr. MISENER. Yes, ma'am. I actually feel very badly for Mr. Cohen because he is in a position of having to try to prove a negative, that it can't be done or they don't want to do it. We are saying we can do it and we will do it for our sellers.

Ms. JACKSON LEE. Well, I think we have come to some means of collaboration here and I hope for those who oppose it we will find a common ground for them as well.

But I think the economy is such, Mr. Chairman, that we need to do that.

Mr. Chairman, may I just get a yes or no answer from Mr. Marshall?

I am not sure if—it looks as if he has a different perspective but, Mr. Marshall, would you be willing to engage in compromise and discussion, listening to the testimony not only that you have given but to others on the—on the panel here, recognizing the loss of resources and revenue that states are losing under the present scheme?

Mr. MARSHALL. Well, if I—if I understand your question correctly, indeed, and as it relates to the small-business exemption, you know, I have small retail stores and I am not exempt.

I collect sales tax on the very first dollar of my sales and, quite frankly, you know, any level of exemption is still picking winners and losers. All you are doing is changing the measure of which are winners and which are losers.

But I would still be competing with some online retailers that wouldn't be obligated to charge that same sales tax that I have to charge.

Ms. JACKSON LEE. Well——

Mr. GOODLATTE. The time—the time of the gentlewoman has expired.

Ms. JACKSON LEE. We will work through that for the gentleman. Thank you. I yield—I yield back. Thank you.

Mr. GOODLATTE. The gentleman from Arizona, Mr. Quayle, is recognized for 5 minutes.

Mr. QUAYLE. Thank you, Mr. Chairman.

My first question is to Mr. Byrne and Mr. Kenley because I want to get kind of opposing views on this. Now, the U.S. Supreme Court has interpreted the due process clause of the 14th Amendment to require that a minimum connection between a state and the person, property or transaction it seeks to tax.

Now, I want to talk about a different avenue that raises some concern. Each of the three bills actually has a clause that says that this doesn't establish a nexus for any other type of tax or payment that is required.

But my concern is since we are kind of getting rid of that minimum connection are we opening the door for other states to actually apply their regulatory environment onto companies who have no physical presence within that state, whether it be they pass a law that bases it if you do not have a physical presence and you meet some sort of threshold with annual revenue, which will be easily ascertained via the sales tax, then they meet that threshold and then they have to actually abide by the regulatory environment in said state.

I will give just a specific example of this, is that Arizona is right next to California, and California and Arizona have very different overtime rules. We have overtime that kicks in a 40-hour work week. Once you go over 40 hours a week, overtime kicks in. However, in California, it kicks in also at the 8-hour day.

Now, are we opening a Pandora's Box where we are actually—since we are getting rid of this connection that we are actually going to allow a court to interpret what Congress has done and also the ability for the state to regulate within its own—within its own environment but since we got rid of that specific connection are we not opening the door to the fact that states will be able to regulate companies that have no connection besides the actual sales into their state?

I will start with you, Mr. Byrne.

Mr. BYRNE. I would think that doing so is—would be a direct insult to the dormant Commerce Clause so I would think it wouldn't be capable of being done. But I have been surprised before.

Mr. QUAYLE. As have I.

Mr. Kenley, do you see any danger of that? That is one of my chief concerns of opening this—opening this door. I understand what we are trying—what is trying to be accomplished by this, these pieces of legislation.

However, if we are not looking at the unintended consequences of this are we opening this door, which would basically eviscerate, you know, a company's ability to kind of look at the states and what their regulations are, to move their facilities there?

Mr. KENLEY. That's a very legitimate question. It is a very legitimate question and one that needs to be carefully considered as we do this because I agree with your fear if that were to happen that that would be totally inappropriate.

There are two things that protect you on this. The first thing is that Congress has the authority and that is why you see the language in the bill that says Congress has the authority to define how you can regulate the interstate commerce.

So if they restrict it to the sales tax instance it is only Congress that can change that and enlarge that and make it be further.

Now, secondly——

Mr. QUAYLE. But in each of the three bills it only talks about the nexus that is established only for state and sales tax and only in terms of the cost, not in terms of regulations or those types of things moving forward. That is where my concern is. Do we need to actually broaden that, the language there, to——

Mr. KENLEY. I think the language could be broadened and I think it should be. I think we—before we pass a bill I think we should look at that carefully. I think the language needs to be

broadened to the point where we feel more confident that it will not do that.

Now, the second backup you have in addition to the fact that Congress gets to set the rules as to what will be happening in interstate commerce is you still have the 14th Amendment due process clause which allows any individual to go to court and say look, this has gone beyond that and it is a due process question too.

So but I agree with your thoughts that this needs to be handled very carefully.

Mr. QUAYLE. Okay. Thank you.

Mr. COHEN. Mr. Quayle, can I add to that?

Mr. QUAYLE. Absolutely.

Mr. COHEN. Because the due process question is particularly important for small businesses who are not necessarily in a position to advocate on their behalf that there would be a due process violation—the lower the small-business exemption is.

So you are exactly along the right lines that it is not simply that just for their sales alone that they may be subject to different state laws but also the collection.

Mr. QUAYLE. Well, one thing, and since we are talking about the small-business exemption I wanted to ask you about this as well is we have different numbers—$150,000, $500,000, $1 million.

I just want to know on eBay, at eBay what percentage of your sellers are—have annual revenues via eBay of $150,000 or over $150,000? Do you—do you know offhand?

Mr. COHEN. So like I said to Congresswoman Lofgren, we have a significant number of sellers that are below that and we have a significant number of sellers that are above that.

But we have very few sellers that only use eBay—they are multichannel retailers in which they use many, many other places. And so therefore they may use eBay for sales. Many of them use Amazon for sales. That's why it makes much more sense to say for each retailer what their obligation is across their entire portfolio of business.

Mr. QUAYLE. Okay. Mr. Misener, do you want to respond to that real quick?

Mr. MISENER. Yes, sir, if you don't mind, Mr. Quayle.

First of all, that means that the sellers are actually smaller than Mr. Cohen is alleging—larger than Mr. Cohen is alleging. They look unnaturally small if you are only counting how they look as an online channel.

But back to the due process point, Mr. Cohen is right except that the *Quill* court already decided that the due process clause does not apply in the context of sales tax collection by—in interstate sales. That was part of the difference between the national Bellas Hess decision and the *Quill* decision. They actually dropped out the due process concern and left only the Commerce Clause concern.

Mr. QUAYLE. All right. Thank you, Mr. Chairman. I yield back.

Mr. GOODLATTE. The gentleman from Georgia, Mr. Johnson, is recognized for 5 minutes.

Mr. JOHNSON. Thank you, Mr. Chairman.

Is there anyone on the panel who disagrees with the thought that government facilitates the ability of Brick and Click or just

Click as well as Brick and Mortar businesses to actually do business?

Is there anyone who disagrees with that, government enables or facilitates your ability to do business whether or not you do it just over the Internet, whether or not you do it over the Internet and you have a Brick and—you have a Brick and Mortar distribution facility or if you are just Brick and Mortar? Mr. Cohen, you?

Mr. COHEN. No, we don't, and——

Mr. JOHNSON. You don't——

Mr. COHEN. We're thankful that the government helped to create the Internet.

Mr. JOHNSON. Okay. All right. Okay.

So now, state and local governments facilitate your ability, your company's ability, Mr. Cohen, to deliver your merchandise. Isn't that correct?

Mr. COHEN. Yes, sir.

Mr. JOHNSON. Yeah. I mean, you got to—somebody has to drive it down a road that was maintained or built by state or local government, the road is laned, it is properly maintained, traffic signals, police officers to enforce the rules of the road, a court system for those who may be accused of—those delivery drivers who may get accused of speeding or something like that they have a right to go to court.

And even if eBay is unable to obtain payment from someone, they may have to depend on the local police or the court system funded by the local government or the state government in order to collect. Is that not correct?

Mr. COHEN. That is correct.

Mr. JOHNSON. Okay. So is there anybody on the panel who thinks that we should do away with state and local sales taxes?

Mr. COHEN. Mr. Johnson, can I continue though? But 2 years——

Mr. JOHNSON. Well, no. I just want to answer that particular question. Sales tax revenues, should they be outlawed so that we can level the playing field between Brick and Mortar and Brick and Click?

Because I am assuming everybody believes that there should be—there should not be a difference in treatment between Brick and Mortar and Brick and Click.

Mr. COHEN. We don't object to that. We think it makes perfect sense.

Mr. JOHNSON. Yeah. So—yeah. So you got to pay the sales tax in order to do the business and so the question is how do we go about collecting the sales tax. That is what we are here for today.

It is not so much, I don't think, that we should not have an obligation by Internet retailers to collect the sales tax. Is that correct? Mr. Byrne?

Mr. MISENER. If I may, Mr. Johnson, I could—quick answer. I think that you are absolutely right that it should be a matter of state choice. States can choose whether or not to have a sales tax.

Mr. JOHNSON. Yeah. And if they—yeah. This just—this——

Mr. MISENER. Texas—yeah. Texas, for example, chose not to have a personal income tax and they—so they rely heavily on a sales tax, and so a company like eBay, which just opened a facility in Austin with a nearly $3 million Texas Enterprise Fund grant,

they are taking advantage, clearly, of Texas' hospitality yet at the same time have not done anything to help with the sales tax collection in the state.

Mr. COHEN. Mr. Johnson, I appreciate the need for state sales taxes in the states that choose to do it. What I do find remarkable, though, is that just 2 years ago Mr. Bezos, when describing what the obligations were for Amazon in states around the country, said, "In Washington State where we have a presence we get police protection. We get fire protection. We send our kids to local schools. I don't see why, since we get no services in North Carolina, that they should be able to force us to collect sales tax."

Mr. JOHNSON. Well, because you do have to—you do have to use the police and the fire and the roads and drainage and that kind of thing. You use that.

Mr. COHEN. No, no. That's what Mr. Bezos from Amazon's position 2 years ago——

Mr. JOHNSON. Well——

Mr. COHEN. Was that he didn't want to have to collect and remit in North Carolina.

Mr. JOHNSON. Okay. All right. Well, things change. [Laughter.]

Things happen. But let me ask this question.

Why is it that we would need a carve-out for small Internet businesses from collecting sales taxes on Internet sales when we don't have an exemption for small businesses Brick and Mortar?

Why should we have one for Brick and Click?

Mr. BYRNE. Congressman, well one reason is there is an implementation cost for the software and there is a friction cost, and if you did a cost benefit analysis you would see that the cost for a——

Mr. JOHNSON. Well, why—how about making it—subsidizing it for small businesses?

Mr. BYRNE. I am all for that.

Mr. JOHNSON. The cost.

Mr. BYRNE. I am all for that. But as long as there is some cost, which there is always going to be, then at some point if you are—if you are having people who sell $10,000 or $20,000 on the Internet have to pick up that cost in order to integrate, that cost is going to be higher than the taxes they actually remit. So it is actually a net loss to society.

Mr. JOHNSON. Okay. Thank you. And you all have been excellent spokespersons for the need for government.

Mr. GOODLATTE. On that note, the time of the gentleman has expired. [Laughter.]

I am going to recognize myself and take us back here.

The history of this is not that this originated with the Internet. In fact, the *Quill* decision was a decision based on a mail order case and the principle—the Chairman asked earlier what was the reason for not giving to the states the ability to collect the money. Well, the reason, of course, was delved into somewhat by the gentleman from Arizona but the principle is that those states who want to impose this collection requirement on taxes have jurisdiction over their citizens.

They don't have jurisdiction over the citizens of other states and therefore those citizens of other states engaged in various business

activities don't have any say in how the laws are constructed in those states that they are going to then be forced to comply with.

So the court ruled that that was the province of the Congress under the Commerce Clause and here we are today and have been for the last at least decade that we have been dealing with this issue.

So the question really becomes one, not only of fairness but also of practicality for those businesses. So my first question for you, Mr. Kenley, is why should the Congress cede the authority, as some of these bills apparently do, to your organization to determine what is the standard for out-of-state businesses to collect these taxes rather than set a standard ourselves and allow that to take place that way?

Mr. KENLEY. The reason that we had originally put forth in having Congress cede the authority with the proviso that you could always appeal anything determined by the Governing Board to the Federal courts, which is the normal process through the interstate Commerce Clause was——

Mr. GOODLATTE. But you would be effectively a legislative body that would set the, for example, size of a small business that would be exempt from having to comply with the collection of the taxes.

Mr. KENLEY. The whole premise of the thing had been with the—when the legislators went to the Governing Board and from their respective states and then they had to go back to their state and then pass their state laws in compliance was that they were acting as agents of the state. And so it was really the states doing it, not the Governing Board itself.

Mr. GOODLATTE. What about the five states that don't collect sales taxes now? How would they fit into this?

Those states would be burdened. In other words, businesses that do business online in those states would be burdened but there would be no benefit to those states because they don't have a sales tax.

Mr. KENLEY. Well, Mr. Chairman, let me go back first and say that the Streamlined organization recognizes that there needs to be an avenue for the states who do not want to join Streamlined and do not want to adhere to those rules.

Mr. GOODLATTE. Would their—would their businesses in those states—if they don't want to have a sales tax collected would they be allowed to exempt those businesses from having to collect state taxes for other states that do?

Mr. KENLEY. I am not sure I follow that question.

Mr. GOODLATTE. Well, if you are in Delaware and you don't have a state sales tax but you have a business in Delaware that is engaged in online businesses and making sales, that business is going to be burdened by having to collect sales taxes for other states, even though Delaware hasn't for all time as I understand it not collected sales tax.

Mr. KENLEY. Well, first off, I would argue that there is no burden on the business because there is no cost to the business to do that.

Mr. GOODLATTE. Let me—let me get to that question. You indicated that you had software that would work for the Streamlined businesses—states, the states that have participated in this.

What about a state that wants to collect this tax but wants to continue its own unique definition of what is subject to tax and what the tax rate is, and do you make a difference between the rates of these 10,000 jurisdictions? Do you have one unified rate or do you have a different rate for each jurisdiction?

Mr. KENLEY. Well, the Streamlined software allows you to handle every jurisdiction in the United States and sort out the rates as well as any other. We have——

Mr. GOODLATTE. So if a state collects—has a local grocery store collect a sales tax——

Mr. KENLEY. Which is my business, yeah.

Mr. GOODLATTE. On potato chips and another state makes a distinction between the size of the bag, and different jurisdictions in different states do that, this software will make that distinction? It will say this is a 5-ounce bag so we are going to not impose the tax but the 12-ounce bag, that is subject to the tax?

Mr. KENLEY. Within the Streamlined rules and definitions we have toggle switches that allow you to exercise choices.

But to go back to your basic question, we do feel that it is appropriate for Congress to enact a bill which allows states not to join Streamlined but to have their own systems and to make some of the——

Mr. GOODLATTE. That complicates the matter for that small business, particularly in a state that——

Mr. KENLEY. Not really.

Mr. GOODLATTE. Doesn't even have a sales tax.

Mr. KENLEY. Not really.

Mr. GOODLATTE. Well, I think the—I will ask Mr. Byrne to respond since he had a very different experience with the cost of the software implementation for his business.

Mr. BYRNE. Yes. I don't believe the software is, at least as of a year ago, it is not—it is what they call in the industry vaporware. It is not as advertised. It is expensive and so forth. However, that is a technical problem that could be solved probably in a year or two.

They could—software could be created that does this smoothly. I still—I think that there is not quite the range of disagreement among us as may first appear, although I would prefer you didn't change anything at all. If you——

Mr. GOODLATTE. But you want a small-business exemption. He says you don't need a small-business exemption.

Mr. BYRNE. Okay.

Mr. GOODLATTE. Tell me why you do need a small-business exemption.

Mr. BYRNE. Well, I think you need a small-business exemption to reflect the fact that there will be implementation and costs for any business. I think the states who want to do this should be providing it for free but there is still going to be an implementation cost and that—for really small sellers that implementation cost is going to be higher than the tax this——

Mr. GOODLATTE. Let me ask both of you this question.

If we are doing this for interstate sales, and I assume you are going to do this for not only online businesses but also mail order businesses, telephonic businesses and so on, if you are going to do

it, why not have one uniform interstate definition of what the tax is?

If a state wants to collect some different formula with different conditions in its state, great. But if it is going to collect sales taxes, require a business out of state to collect taxes, why not have one uniform definition of what is subject to the tax and one uniform interstate tax? Some states that have a very high sales tax, well, they may lose a point or two.

Some states with a low sales tax, they might gain a point or two. But for the business doing business online, it would seem to me a lot more practical and a lot more fair to say this is the rate that you have to pursue if you are going to do business online.

Mr. BYRNE. Sir, I agree. That is very much in the direction of the bill that we are proposing. What we are saying is don't do it but if you are going to do it don't go with the Streamlined project, which will end up—it doesn't create a uniform system.

It is still a complicated system. Go with a much simpler uniform system but where the states are—the bill as we propose it would still allow the states to keep their individual rates but they would have to provide the software and the interface but it would be uniform. What you are proposing is going a step further where even the rates get unified, which I would applaud.

Mr. GOODLATTE. Mr. Kenley, I want to give you an opportunity to respond to that but my time has expired so be brief.

Mr. KENLEY. I struggle with—I struggle with your—the thing that you posit there because it intrudes so much on the federalism and the state sovereignty side of the issue. And so I think——

Mr. GOODLATTE. It is interstate commerce. It is—it is business being conducted across state lines. It is not something that is confined within the jurisdiction of a state. That is why we are here. That is why the court ruled as it did in *Quill*.

Mr. KENLEY. Well, I—I will have to think that through and I am not sure if I can buy that on that basis. But let me think about that.

But, secondly, let me say that the technology that we have today, even within Streamlined, allows those toggle switches to be developed to allow states to have different choices both as to rates and both as to the—your example on the bag of potato chips, which is taxable and which is not taxable.

So those are things that are being done within that realm.

Mr. GOODLATTE. Anybody else want——

Mr. KENLEY. And I think the technology allows us to solve that without it being a problem.

Mr. GOODLATTE. Anyone else want to comment on this point? Mr. Otto?

Mr. OTTO. I think—I am okay with the states having to provide the solution and hold the retailer harmless as long as they are using it. I mean, there is nothing wrong with that.

The same thing that the Streamlined compact has done why couldn't the states that maybe don't want to join Streamlined, don't want to change their definitions, but maintain the definitions uniformly throughout their state be allowed to develop the software to give to the retailer?

Mr. GOODLATTE. But now you are talking about having a small business having to deal with a variety of different software programs.

They have got one program for the Streamlined folks and then you have got 20 other——

Mr. OTTO. Most of these are going to end up in——

Mr. GOODLATTE. States with different definitions and you got 20 different software programs that——

Mr. OTTO. Not if the states go together to form a compact to develop it.

Mr. GOODLATTE. Right. But that is—but that is why the suggestion that you have one definition and one rate——

Mr. OTTO. But are you talking about one definition for all the states or a definition within each state?

Mr. GOODLATTE. No, no. One definition for all the states and one flat rate.

Mr. OTTO. Then I have to agree on the—on the, you know, from a federalism standpoint I am not—the reasons Texas doesn't belong to the Streamlined sales compact is we are not willing to give up that right to determine what is taxable and what is not taxable.

Mr. GOODLATTE. I understand, but you are making it harder to get to where you want to go in terms of collecting sales taxes through businesses that are not under your jurisdiction in your state.

Mr. OTTO. Then what we are going to end up with is what we have today, which is states going out on their own to try to define physical presence in all kinds of ways.

Mr. GOODLATTE. Well, I think we need to develop more consensus here. That would be my observation.

Ms. Chu, the gentlewoman from California, is recognized for 5 minutes.

Ms. CHU. Thank you, Mr. Chair.

Well, before I came to Congress I was elected to the California State Board of Equalization, whose main responsibility it was to collect the state sales tax as well as the use tax, and I can attest to the dramatic decline of sales tax revenue as a proportion of the state budget revenue because of online sales and I can also attest to the complete lack of compliance with use tax obligations despite the fact that we have a line on our income tax forms reminding people of their use tax obligation.

And besides that, what I found was that few people even know what a use tax is and are shocked to find that they actually owe that tax regardless of whether they buy online or not.

So I would like to ask our two state representatives, Senator Kenley and Representative Otto, why are the current methods of collecting the use tax such as auditing not an effective way to collect use tax?

Mr. OTTO. In Texas, because we do not have a personal income tax, the only audit provision you have on use tax is a business that holds a sales and use tax permit.

Those are the only people that would be buying across state lines that would be subject to audit for the purposes of determining whether they had paid the appropriate amount of use tax.

We have no form. We have no reporting system for individuals or anybody else unless they hold a permit to comply with paying the use tax.

Ms. CHU. Do you even have auditors that do such things?

Mr. OTTO. Yes. We have auditors. The comptroller, you know, because sales and use tax makes up a very large portion of our state budget and from the revenue standpoint we have auditors that are very aggressive.

Ms. CHU. And Senator Kenley?

Mr. KENLEY. Well, in Indiana we do have an income tax. Certainly, what you are suggesting would be a Full Employment for Auditors Act.

It would require an awful lot of auditors, and I pointed out earlier in the testimony that it seems that traditionally sales tax has been administered by the retailer doing the collection and being given an allowance to do so to try to cover their cost of doing that, and it is the most efficient way of doing—making the collection.

Now, a secondary problem, and we have talked about this in Streamlined, is once you start trying to find ways other than hiring legions of auditors to do this to make this work out, then you for example, you might say somehow or other we are going to demand that all the credit card companies send us a cross-reference file on all the purchases by a consumer and then so you get into that and then all of a sudden with a married couple you have a discussion about well, gee, what was this purchase from Victoria's Secret, I don't remember that.

And so there is a element of privacy intrusion there that we are uncomfortable with, I think, as public officials to go too far on that point.

So that is—those are the concerns that we have discovered in that audit process. It may be over time that people will declare and pay use tax because it is becoming more a phenomenon that we are all shopping over the Internet in one way, shape or form.

So maybe it is a experiential factor. But I think there are some barriers to going a different way than we have in the past traditionally, which is that the retailer does the collection and the remission.

Ms. CHU. In other words, it is expensive and inefficient to use auditors to collect the use tax.

Mr. KENLEY. Right. Since you are doing it at the time of the transaction with the retailer it just kind of fits within the flow of the commerce system.

Ms. CHU. And what would it mean to your states, to your respective states, if you were able to collect the remote sales tax?

Mr. KENLEY. What would it mean to the states to——

Ms. CHU. For your—for your state budget.

Mr. KENLEY. The estimates in Indiana run anywhere from $150 million a year to $400 million a year under the current situation.

I think the bigger issue that we need to think about here today in Congress is that this is a growing part of our commercial environment so it is probably going to be a growing number regardless of what number you project or settle on.

Mr. OTTO. In Texas, the current estimates are $600 million to $800 million per year.

Ms. CHU. And finally, I would like to ask Mr. Misener of Amazon, Mr. Byrne said that it was very onerous to have a software to collect sales tax revenue and that it cost $300,000 and many man hours of the IT staff. But you seem to have a different view regarding the type of technology that is available to help collect the sales tax.

Can you talk more about that and about the purchasing of software to remit sales tax in locations where you do have nexus, and does the technology exist?

Mr. MISENER. Thank you, Representative Chu. Thank you very much.

Yes, we do collect, as I mentioned before, in the four states where we have—our retail business has a physical presence and thus we have nexus there, and so it is possible. You only need to look around and see all the multi-channel retailers who also are collecting nationwide in 46 states.

So it is absolutely doable. Now, you might say, well, those are only big companies like Amazon and the multi-channels—what about the little guy.

Well, the little guy will get services provided for him or her. Those small sellers won't have to create the software from whole cloth. They will obtain it as a service from service providers and it certainly is something that we plan to do.

I certainly hope eBay does it and maybe our friends at Overstock will sell through Amazon and take advantage of our service as well.

Ms. CHU. Thank you. I yield back.

Mr. GOODLATTE. The gentleman from Florida, Mr. Ross, is recognized.

Mr. ROSS. Thank you, Mr. Chairman.

Mr. MARSHALL, DR. Byrne indicates in his written testimony that based on the *Quill* decision the status quo is a success. Would you agree?

Mr. MARSHALL. No. I don't agree at all. You know, I feel the current situation is picking winners and losers, and retailers incur expenses and benefits in all types of sale endeavors and if I choose to sell nationwide I am perfectly comfortable incurring the responsibility of collecting and remitting the sales tax for those purchases just as I do at my retail stores for state of Michigan residents.

It is—any level of consideration for a certain size or a certain type of retailer is creating a unlevel playing field and that is what is difficult is not to be able to compete on a level playing field with all other players in the retail Internet or retail——

Mr. ROSS. With your customer base.

Dr. Byrne, you indicated in your opening testimony, of course, that the cost of compliance is rather significant. I mean, you have got over 9,000 taxing districts I think you alluded to. Wouldn't this legislation, the Marketplace Equity Act, quite frankly, you know, bolster your concern and even give an argument that we need this because we would have uniformity in the taxing laws?

Mr. BYRNE. Well, I think that the bills as proposed would not—the Streamlined initiative would not create uniformity but that is why we have proposed a bill that says if you are going to do this, this is the way to do it.

It really does create uniformity. It lets the—where the states indemnify. But it also has a provision where there is a small reimbursement of——

Mr. ROSS. And that is what I want to talk to you about because I think that that is important, and when you talk about cost of compliance it doesn't matter whether you are a small Bricks and Mortar retailer or an e-tailer. The cost of compliance is something that you have to face as a cost of doing business.

So would you propose and what would you propose a cost of collection that would be—that would be adequate compensation for your business if you were to do this?

Mr. BYRNE. Two to 3 percent of the taxes that we collected on behalf of the state would be our fee and that would be—that would not just be Internet people. That would be for Brick and Mortar people. So it would create a truly level playing field.

Mr. ROSS. And Mr. Otto, I—when I served on the floor of the legislature I was an advocate of and sponsor of the Streamlined Sales Tax initiative. It got nowhere, I mean, and I understand that.

But would you not agree then that maybe as an—as an inducement for these online companies that they should be compensated at least to cover the cost of their collection from an administrative——

Mr. OTTO. Texas currently has a collection allowance of ½ percent that we grant but not all states do. Again, this is a question of—you know, I agree. The reason we have left it in our law is to try to compensate retailers in our state that collect and remit the sales tax.

Mr. ROSS. Senator Kenley, would you agree, I mean, that there ought to be some compensation at least to cover the cost of collection?

Mr. KENLEY. Yes, and within the Streamlined agreement we struggled and worked to reach a compensation agreement that's a three-tiered compensation agreement with a higher level of compensation for the smaller retailer, and it moves down as you get larger and we think that provides adequate compensation. Plus, we have the free software and the certified service provider system.

Mr. ROSS. Mr. Cohen, you were asked this question and I am not sure I got the answer. How many of your members would be affected by the exemption that is currently being proposed in the Marketplace Equity Act? Do you know?

Mr. COHEN. The Marketplace Equity Act is——

Mr. ROSS. As Representative Womack's and Speier's bill. It is the——

Mr. COHEN. The $1 million?

Mr. ROSS. Yes, $1,100,000.

Mr. COHEN. Like I said, we can't determine the users that go outside of our system and use others. There are a significant number that would be above the threshold.

Mr. ROSS. Dr. Byrne or Mr. Misener, did you want to speak to that?

Mr. MISENER. I am pleased to be called Doctor.

Mr. ROSS. I am sorry. I was just—thank you. [Laughter.]

Dr. Byrne, let me ask you a question because this is something that is—in my position back home, I have a couple, married couple,

Ron and Nancy, put their life savings in a small retail boutique retail out—a store.

They sell barbecue grills, they sell smokers and accessories, and they constantly have open houses. They are a great corporate partner for the community, doing fundraisers.

But people come in and try their products. They try their spices that they buy through a distribution center. They try their products. They measure them. But when it comes to purchase, and this is their complaint to me, is that they as a retailer are now having to negotiate with the consumer whether they will discount at 6 percent, which is our state sales tax there, and they say they can't do it.

My question to you is how do I respond to them? I mean, there is a—there is a desperate need there for community partners in the retail establishment, those who invest their life savings in Bricks and Mortar to make sure that their livelihoods are not only maintained and fulfilled but also that their communities are better off because of their investment.

How do I respond to them when I say, I am sorry, we don't have any enforcement jurisdiction to allow you to have an even playing field in the retail environment with online retailers?

Mr. BYRNE. Well, Congressman, I love the Brick and Mortars. I have been a Brick and Mortar guy myself. There are advantages and disadvantages of being Brick and Mortar. But what I would really say is that their pressure came from the big-boxes.

It is the big-boxes who have taken over 87 percent of retail and so that is really where their competition has come from. There is other small retailers in some other state than yours who is maybe selling their barbecues online and so it creates winners and losers.

The issue is, I think, as Mr. Cohen said, it is a false dichotomy to view this as Internet players versus small Brick and Mortars. It really is the big-box retailers versus small entrepreneurs.

Mr. ROSS. But the small entrepreneurs are the ones who make the investment to allow the consumer to see the product and then the consumer makes the choice to buy it online because they don't have to pay sales tax. And I see my time is up and I yield back.

Mr. AMODEI [presiding]. Thank you, Mr. Ross.

The gentleman from Florida is recognized.

Mr. DEUTCH. Thank you, Mr. Chairman.

I would just like to follow up on that point, Mr. Byrne. I don't—I don't know that it is entirely accurate to try to couch this in terms of—to shift the debate to a battle between smaller retailers like Mr. Marshall and the bigger retailers.

The fact is in many ways some of the smaller retailers—correct me if I am wrong—who have specialized products sell those products.

That is—those are the products where the consumer has to go online if they want to try to find a lower price and often does, and when you speak about the benefits, and this is a question I would like to put to you and to Mr. Marshall because you spoke, Mr. Byrne, about the benefits that Brick—that Brick and Mortar retailers have and the advantages they have and people being able to go in and touch the product, people being able to go in and interact

with someone directly, to have questions answered about the product.

What are the—what are the benefits? Let me start with you, Mr. Marshall. What are the benefits, given all those wonderful benefits that you have, why would anyone go online ever to buy a product?

Mr. MARSHALL. Well, in many cases, that purchase decision, in a final analysis, is based on price. Every hour of every day our sales associates entertain customers' questions, provide demonstrations, allow them to evaluate different instruments and then they are confronted with okay, now, you know, here is the best price I can get on the Internet, can you match that.

And with our 6 percent sales tax we could and we comfortably do with Internet retailers that also charge sales tax. But those that have that competitive advantage it is just a burden that we cannot overcome.

It is an unlevel playing field and there is just no logical sense to it, and engaging that customer and saying well, you understand that this 6 percent that we have in our price we are not taking that, we are giving it to the state, you know, the customer doesn't care. You know, the bottom line is price in so many cases, and in this unlevel playing field we cannot compete with that.

Mr. DEUTCH. Mr. Byrne?

Mr. BYRNE. Well, that is why the bill that we have proposed totally eliminates the tax benefit. What we are saying is if you are going to do something don't—you know, you can level a playing field by either, you know, filling in dirt on one side or scraping it off the other.

Our bill says if you are going—if you are going to do this it totally eliminates the tax—the tax benefit of shopping online versus Brick and Mortar and it says let us—since the states are now deputizing or not just deputizing, conscripting retailers to do their work for them as tax collectors, there should be a—they should be providing the software. They should be indemnifying us and Mr. Marshall against mistakes and they should be reimbursing us as well.

Mr. DEUTCH. All right. So let me—since Mr. Womack and Ms. Speier are so committed to this issue that they have sat through this hearing, let's assume for a moment that the legislation that they have introduced passed the Congress and was signed into law by the President tomorrow.

What would—in the—as you talk about all of the potential costs, and I would like to actually open this question to Mr. Misener and Mr. Cohen as well as Mr. Byrne, what would you have to do? How much would it actually cost? What would the burden be to you?

Mr. BYRNE. Myself first?

Mr. DEUTCH. Mm-hmm.

Mr. BYRNE. On the—right now would be fairly cost, I would imagine, a couple of million dollars and a year of sort of integration to the different commercial packages that are available and there would still be a liability because no one is yet guaranteeing that if we use the package——

Mr. DEUTCH. I understand.

Mr. Cohen?

Mr. COHEN. We believe there would be a significant loss of sales from a significant number of sellers who would leave online platforms and go to either using places in which it would be much harder to collect from, use other types of services where they wouldn't, for example, ad words or other systems in which the auditing of different states would not apply to them.

That is why we are so adamant that we would like a significant small-business exemption so that they are not driven from the Internet. We think the cost will go up, absolutely.

Mr. DEUTCH. Well, I understand you think the costs will go up and Mr. Marshall's argument is the cost is going to go up. You are going to bear some additional cost. He bears an inordinate amount of additional costs by having his store open so the customers can come in and look at the products before going online. What—I don't understand. The customers are going to be driven where?

Mr. COHEN. To larger retailers. Just to larger retailers. I mean, the cost advantage that Amazon has right now will be magnified without—some pushback on small businesses who have a sales tax advantage, no question.

Mr. DEUTCH. Mr. Marshall, is that a battle you are willing to engage in? Do you think that is right that everyone——

Mr. MARSHALL. We do every day.

Mr. DEUTCH. Everyone is going to leave and run off to the larger retailers?

Mr. MARSHALL. Well, that is a battle that retailers, small retailers, are joined every day and comfortably joined. You know, it is a competitive world and, you know, if you can't stand the heat you shouldn't be in retailing. But as long as the field is level, you know, we will battle the big retailers.

We have advantages over them. You know, we have a connection with the community. You know, our—you know, it is a level playing field and there is benefits and drawbacks to being a big-box and being a small retailer. That is just fine.

Mr. DEUTCH. But at that point—at that point, the big-box retailer, the smaller retailer, the online, at least at that point there is a level playing field to engage in that.

Mr. MARSHALL. Absolutely.

Mr. DEUTCH. Thank you. Thank you, Mr. Chairman.

Mr. AMODEI. Thank you, Mr. Deutch.

The gentleman from Texas is recognized, Judge Poe.

Mr. POE. Thank you, Mr. Chairman.

I want to start with you, Mr. Otto. Just so everyone on the panel or the Committee understands, the Texas legislature meets every 2 years for 5 months. Is that correct?

Mr. OTTO. That is correct.

Mr. POE. And yet Texas is, what, the 13th largest economy in the world, something like that. And your primary source of revenue for the state is——

Mr. OTTO. Sales and use tax.

Mr. POE. Sales tax and use tax. It seems to me—let's talk about Dayton, Texas. People who build a building and sell a product take a greater risk than someone that is somewhere else in the fruited plain selling through the Internet.

In Dayton, just since you have been elected, you have had Hurricane Katrina, Hurricane Rita, Hurricane Humbert, Hurricane Gustav and Hurricane Rita all hit Dayton, Texas. Some of those Main Street businesses were destroyed, rebuilt, destroyed, rebuilt, destroyed, rebuilt.

It seems to me that that is a risk they take yet they have a disadvantage with the Internet service retail. Do you agree with that or not?

Mr. OTTO. That is true in Dayton, Texas. That is true anywhere in the state of Texas.

Mr. POE. Yeah, I know. The whole state, whether it is fires or hurricanes or droughts, all of that has, you know, occurred since recently.

Tell me about your concept that this is not a new tax. You know, nobody wants new taxes on anybody. Well, most people don't want new taxes.

Mr. OTTO. I, for one——

Mr. POE. Tell me—explain that to me. Make it simple.

Mr. OTTO. Right. I don't—this is not a new tax.

Mr. POE. Yeah. You are a CPA but keep it simple.

Mr. OTTO. All right. This is a tax that, when the sales tax laws were passed decades ago, the use tax was put into existence. This is not a tax that the business pays. This is a tax on the consumer that the businesses that retail collect on behalf of the states.

So this is not a new tax we are imposing. It is a tax we have been unable to collect partly because of the line drawn in the *Quill* decision. But even in that, we have—I mean, Amazon, we had a—we had a battle with them this session.

They have a distribution center in Irving, Texas, owned by a wholly-owned subsidiary and are not collecting the Texas sales tax.

I have read *Quill* over and over and I can't find where that is not physical presence but—and before we went into session the comptroller sent them a tax due notice for $269 million that should have been collected over a 4-year period.

Mr. POE. Has that tax been paid?

Mr. OTTO. Not to my knowledge. So what we are looking at is in order to avoid—what I don't like seeing on the landscape right now for Texas and for any other state is what states are trying to do to, in my way, Mickey Mouse the definition of physical presence, all right, and that is not a desired outcome.

We need to create a level playing field where everybody understands the rules and they are very clear. This bill that has been introduced in the House calls for simplification. It calls for software to be provided. All of these additional costs the states are going to have to front that.

If we want to take advantage of the—of the provisions that are going to be made available to us in this legislation, we are going to have to come up with the money to provide that software.

Mr. POE. Sales tax revenue in the state of Texas, has it been going up? Has it been going down? Is it about the same?

Mr. OTTO. Well, when I first got to the legislature in 2005, the—our sales tax revenues were growing at double-digit percentages until we hit the current recession. We have just now become where our August sales tax collections for 2011 got back to the level the

were at at 2008 pre-recession but they are not back to the 2006-2007 levels that they were at and what I would call our peak economy.

Mr. POE. There are a lot of factors, of course, involved in that. Is one factor or not the fact of consumers buying online?

Mr. OTTO. That is correct. I will tell you what is driving our recovery right now is the oil and gas sector down in the Eagle Ford formation in south Texas. We have got an oil and gas boom going on that is driving most of the sales tax. Our housing sector has not come back, which is a big driver in sales tax in the state.

Mr. POE. One other question. What is the biggest store in Dayton, Texas? It is not Sonic but what is it?

Mr. OTTO. Oh, wow.

Mr. POE. Well, let's go to Houston. Here is an example.

Mr. OTTO. Probably Western Auto.

Mr. POE. Western Auto. I have seen this and I have heard about this phenomena where a consumer goes into, let's use Best Buy, finds the TV they want and while they are there, they are ordering it on the Internet right there in the store, the Main Street store—ordering it on the Internet because they can get a, you know, no sales tax. Texas 8½ percent, 8¼?

Mr. OTTO. 8¼.

Mr. POE. So they can save that 8¼ percent by ordering it in Main Street business the same TV set. That jus doesn't seem right to me.

Mr. OTTO. It doesn't. We had the same kind of testimony before the House Ways and Means Committee this last session that that was occurring on big-ticket items.

Mr. POE. All right. Thank you, Mr. Chairman. I will yield back.

Mr. AMODEI. Thanks, Judge.

The lady from California, Ms. Sánchez.

Ms. SÁNCHEZ. Thank you. I feel like the last person who gets to go at a roast and all the best lines are already taken. [Laughter.]

I appreciate your patience in hanging in here and I have listened to all of the testimony and the questions with a lot of care. So, hopefully, I won't be repeating some of the points that some of my colleagues made.

I want to start with Mr. Marshall. Mr. Marshall, I understand you are a family-owned business. It is second generation.

Mr. MARSHALL. Correct.

Ms. SÁNCHEZ. And that you have seven physical stores. Didn't start out that way, did it?

Mr. MARSHALL. No. It was just in the last 15 or 20 years that we expanded from a single location to seven.

Ms. SÁNCHEZ. When you opened that single location, did the government help you with any of the costs of collecting sales tax on the items you sold in that Brick and Mortar store?

Mr. MARSHALL. Well, it——

Ms. SÁNCHEZ. Did they subsidize any of that for you?

Mr. MARSHALL. It predates my time but to my knowledge, no. The system that exists within the state of Michigan for collection of sales tax, you know, seems reasonable and there are—there are considerations shown for the burden that we incur collecting it.

The government did assist in the creation of Marshall Music because my father was a pilot in World War II and my mother worked for the government during World War II, and it was savings that they accumulated during that time that made the down payment on their first music store.

Ms. SÁNCHEZ. Okay. I am somewhat facetiously highlighting that point because there seems to be a lot of consternation about the cost of implementing, you know, compliance with collecting sales tax revenue through online purchases.

Now, you have admitted that you also sell products online. Is that correct?

Mr. MARSHALL. Correct.

Ms. SÁNCHEZ. And what percentage, just roughly, can you give me a ballpark, of your business is done through online sales versus the Brick and Mortars that you own?

Mr. MARSHALL. Less than 1, 1½ percent online.

Ms. SÁNCHEZ. Okay. So if you were—if we were viewing you strictly through the lens of your online sales and what you take in on a yearly basis through those online sales, under some of the definitions that people have proposed for the small-business exemption you might look like you actually were a small business that qualified for that exemption, would you not, if we were strictly looking through the prism of what a small business does in online sales?

Mr. MARSHALL. Indeed, and I apparently would not have to collect sales tax and would have a competitive advantage over those that do. You are—it would—you know, it would still be picking winners and losers.

Ms. SÁNCHEZ. And so, you know, with some of these, you know, proposed limits for what a small-business online retailer is, and I believe, Mr. Cohen, and you can correct me if I am wrong, you don't know exactly what percentage of people strictly sell online but very well could be a situation like Mr. Marshall's situation in which part of their portfolio of sales is online but, you know, you could—and they could look strictly through that prism like a small-business entity but in fact they could be doing millions or billions of dollars worth of business through other, you know, platforms from which they sell.

Is that correct, Mr. Cohen?

Mr. COHEN. Yeah, and for many online and for many Main Street retailers we think the Internet is a great way for them to expand their business. Exactly.

Ms. SÁNCHEZ. I understand but, you know, again, the—you know, creating these artificial distinctions between Brick and Mortar and online sales and small-business versus—you know, what is the definition of small business.

I have listened with a lot of attention to the small business discussion because I used to serve on the Small Business Committee, and the definition of small business pretty much is in the eye of the beholder because if you look at SBA, government entity, you know, their definition in some instances is 500 or fewer employees.

And if you asked the average person out on the street does 500 employees sound like a small business to you I think most people would say no. If you look at the IRS and the filings that they re-

ceive, in the IRS's eyes—most businesses in the United States employ five or fewer people, and if you asked the average man out on the street does five or fewer people sound like a small business to you I imagine most people would say yes. And yet, you have these huge disparities in what the definition for small business is.

So with respect to the small-business exemption and with all due respect to the idea that there are some start-up costs to starting a new system and to implementing it and to recouping those sales taxes, you know, those are—those are expenses that Brick and Mortars incur and nobody is—nobody helps them with the cost of that transition or the cost of that—doing business that way.

And so I think we need to be very careful in terms of when we talk about small-business exemption what exactly the criteria should be because something that looks like a small business through small-business online sales could actually be somebody that does a lot of—generates a lot of sales in another context.

And I see that my time has expired. I thank you all for your participation and for your patience and I yield back my time.

Mr. AMODEI. Thank you, Ms. Sánchez.

I would like to thank our witnesses for their testimony today.

Without objection, all Members will have 5 legislative days to submit additional written questions for witnesses or additional materials for the record. The hearing is adjourned.

[Whereupon, at 12:42 p.m., the Committee was adjourned.]

# APPENDIX

## Material Submitted for the Hearing Record

# UNCOLLECTED SALES TAXES ON ELECTRONIC COMMERCE: A REALITY CHECK

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## UNCOLLECTED SALES TAXES ON ELECTRONIC COMMERCE: A REALITY CHECK

### EXECUTIVE SUMMARY

Under the Supreme Court's 1992 *Quill* decision, online retailers are not required to collect sales taxes in states where they do not have a physical presence, or "nexus." As a result, state and local sales taxes are not collected on some proportion of interstate sales. Since the early days of the Internet, state and local governments have lobbied Congress to overturn *Quill* and force e-retailers to collect taxes on all sales, regardless of whether they have nexus.

The amount of uncollected taxes involved is central to the debate. Overturning *Quill* would impose significant administrative costs, especially on small businesses (where administrative costs account for as much as 13.5 percent of taxes collected), and would have other negative consequences as well. If, the resulting tax collections would be too small to materially affect state and local government finances, then governments arguably should look elsewhere for a solution to their fiscal difficulties.

In this study, we present an estimate of the amount of potential uncollected sales tax revenues for 2008, and a forecast of uncollected revenues through 2012. Our primary findings are:

- Total potential uncollected sales tax revenues in 2008 were approximately $3.9 billion, or less than three-tenths of one percent of state and local tax revenues.

- More than one third of uncollected revenues are associated with small businesses. If firms with less than $5 million in remote sales were exempt (as proposed by legislation introduced in recent Congresses), potential uncollected revenues fall to approximately $2.45 billion, or less than two-tenths of one percent of state and local tax revenues.

- Uncollected revenues are not rising rapidly. Uncollected revenues (from firms with more than $5 million in remote sales) will average approximately $2.67 billion over the 2008-2012 period, or about two tenths of one percent of total state and local tax revenues.

- The growth of "brick and click" retailing (i.e., brick and mortar retailers with substantial online sales) is likely to reduce the proportion of online sales on which taxes are not collected. In addition, states are using various tactics to promote tax collection by "out-of-state" firms. These two trends suggest that uncollected revenues are likely to fall over time – i.e., that the uncollected revenue problem is "solving itself."

- A few large firms account for the bulk of uncollected tax revenues. For example, the top 10 firms (ranked by uncollected taxes) account for approximately 47 percent of total uncollected revenues. This finding provides some support for those who have argued that the states should focus their efforts on firms with large uncollected tax revenues.

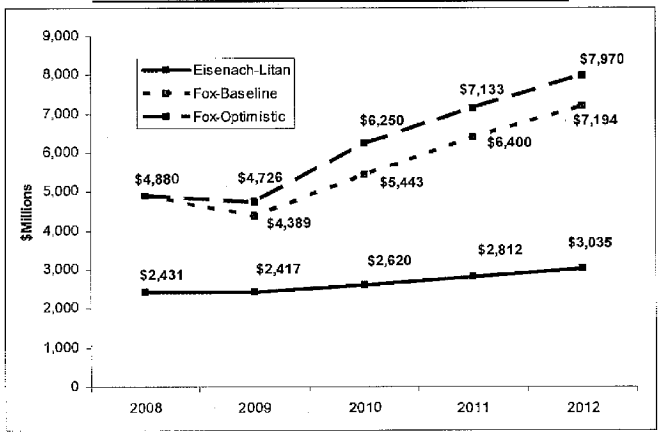
Our findings differ markedly from those of a recent study by a group at the University of Tennessee (the *Fox Study*), which estimated uncollected tax revenues associated with *Quill* at

over $7.7 billion in 2008, rising to as much as $12.7 billion in 2012. The differences can be attributed to three primary factors:

- First, the *Fox Study* substantially overstates uncollected taxes associated with business-to-business (B2B) online sales.
- Second, the *Fox Study* understates tax collections by small firms.
- Third, with respect to "out-year" projections, the *Fox Study* assumes an unrealistically high and unsustainable growth rate for online sales, especially considering the fact that the growth of broadband penetration among U.S. households – one of the primary drivers of online sales growth – is slowing as household broadband penetration approaches saturation.

The differences between our results and those of the *Fox Study* are summarized in the figure below. In our view, the most significant difference is in the rates of growth: Rather than growing rapidly, as the *Fox Study* suggests, our analysis demonstrates that uncollected revenues are, at most, growing slowly. Given that uncollected revenues account for such a small proportion of revenues, our assessment is that state and local tax collectors would be best served by focusing their efforts on other potential revenue sources.

**POTENTIAL UNCOLLECTED REVENUE FORECASTS, 2008-2012**



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## I. INTRODUCTION

In its 1992 *Quill* decision,[1] the Supreme Court affirmed prior holdings that state sales tax regimes were so complex that forcing out-of-state firms to collect taxes would present an unreasonable burden on interstate commerce. Consequently, the court ruled that retailers could not be forced to collect sales taxes for states where they do not have a physical presence, or "nexus." While states also require buyers to pay "use taxes" in lieu of unpaid sales taxes, and businesses generally do so, use tax compliance is generally agreed to be relatively low among consumers. As a result, states and localities have long complained that the growth of e-commerce – a portion of which is comprised of remote sales – is depriving them of significant tax revenues, and have sought legislation that would overturn *Quill* and force online retailers to collect and remit state and local sales taxes on remote sales. Retailers, on the other hand, argue that the administrative costs of collecting taxes for several thousand state and local sales tax jurisdictions would be overly burdensome, especially for small businesses that likely have *de minimis* sales in many states.

Whether it makes sense to overturn *Quill* depends in part on how much additional tax revenue would actually be generated. If the potential increase in tax revenues is sufficiently large, some would argue that it would be worthwhile to incur the administrative costs (both public and private) required for collection; otherwise, the government should look elsewhere for revenue sources that involve lower welfare costs to society (as a share of taxes collected).[2]

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[1] 504 U.S. 298, 112 S.Ct. 1904.

[2] Of course, administrative costs are not the only consideration. In general, the most efficient taxes are those which generate the lowest deadweight losses, including the costs of economic distortions as well as administrative costs. See e.g., Edgar K. Browning and Jacqueline M. Browning, *Public Finance and the Price System* (New York: MacMillan Publishing, 1979) at 288-294.

Several studies have attempted to estimate the magnitude of uncollected sales taxes associated with out-of-state online sales. The most widely cited analysis, by Donald Bruce, William F. Fox, and LeAnn Luna at the University of Tennessee (the "*Fox Study*"), estimates that state and local governments will fail to collect between $44.8 billion and $49.1 billion in tax revenues on online sales over the five-year period between 2008 and 2012.[3] While these estimates are still quite low as a proportion of total state and local tax revenues (about 0.6 percent), or even state and local sales tax revenues (about 2.5 percent),[4] they are sufficiently large that states and localities have cited them in support of their efforts to promote Federal legislation. Other analysts have suggested these estimates are too high, that the actual amount of tax revenues foregone is much lower, and that the amount of additional taxes that might plausibly be collected is lower still, especially since Congressional proposals to mandate collection of remote sales tax have exempted small business retailers.[5]

In this study, we provide estimates of the potential state and local sales tax revenues from Internet retailers, using data from a range of sources, including a recent comprehensive survey of retailers doing business both on and off the Net (both pure Net retailers and those using the "bricks and clicks" model). Our estimates of lost revenue are far lower than those in the *Fox Study* – at $3.9 billion for 2008, slightly more than half. Moreover, assuming – as seems

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[3] Donald Bruce, William F. Fox, and LeAnn Luna, *State and Local Government Sales Tax Revenue Losses from Electronic Commerce*, *University of Tennessee Working Paper* (April 13, 2009) (hereafter *Fox Study*).

[4] For example, the *Fox Study* estimates uncollected revenues of $7.26 billion in 2008. The Census Bureau reports total state and local tax revenues for the 12 months ended December 2008 were $1.304 trillion, and state and local sales and gross receipts taxes for this period were $305 billion. See U.S. Census Bureau, Federal, State and Local Governments: Quarterly Summary of State and Local Government Tax Revenue (http://www.census.gov/govs/www/qtax.html, viewed August 31, 2009).

[5] See, e.g., Billy Hamilton, "Internet Sales Tax: What If There's No There There," *State Tax Notes* 49 (September 1, 2008) at 627 and Peter A. Johnson, *Setting the Record Straight: The Modest Effect of Ecommerce on State and Local Sales Tax Collection* (Direct Marketing Association, January 19, 2008).

extremely likely – that a sales tax collection mandate would include an exemption for small businesses, the amount would be even less: Approximately $2.4 billion, or *less than two-tenths of one percent* of state and local government tax revenues. In the balance of this introductory section we explain why our estimates differ from the *Fox Study*, and in the rest of the paper, we provide the details.

The amount of revenue that would be generated by a mandate to collect remote sales tax depends on three primary factors: (1) The dollar amount of taxable e-commerce sales on which taxes currently are due, but not collected; (2) the applicable tax rates on these sales; and, (3) the "reach" of the mandate, i.e., the revenues that would be exempted if, for example, small businesses were not covered (or, realistically, if there was a significant amount of non-compliance). Unfortunately, none of these three magnitudes is directly observable, and it is therefore necessary to develop estimates. For example, while there are both public and private estimates of the total amount of retail online sales, it is necessary to estimate the proportion of these sales accounted for by products (e.g., food products, intangibles) that are exempt from state and local sales taxes. Of the remainder, it is necessary to estimate the proportion of sales for which taxes are already collected, either because they are made to customers in states where the seller has nexus, or because the buyer pays use taxes, which is typical for most business-to-business (B2B) sales. Once an estimate of untaxed sales is developed, the overall sales figure must be allocated across jurisdictions in order to apply the appropriate tax rates. Finally, in order to make going-forward projections of lost tax revenues, it is necessary forecast the key underlying variables for future periods.

In this study, we utilize data from a variety of sources to estimate the amount of uncollected sales taxes on electronic sales for 2008-2012. The starting point for our analysis is a

survey of sales tax collection practices of the largest online retailers as reported by *Internet Retailer*, which reports annual online sales revenues for the 500 largest Internet retailers, including both "pure play" online retailers (like Amazon.com) and "brick-and-click" or "multichannel" retailers (like Target and Wal-Mart). To ascertain the extent to which these firms collect sales taxes on online sales, we went beyond the data in the *Internet Retailer* report to survey the sales tax collection practices of 250 firms (including the top 150, the bottom 50 firms and 50 from the "middle" of the distribution) to ascertain the states in which sales taxes are already collected on online sales by the top 500 firms. We also develop estimates for uncollected taxes by smaller firms, which represent about $28 billion, or 21 percent, of 2008 online sales. Finally, we also forecast online sales and uncollected revenues for the five-year period 2008-2012.

As indicated, we estimate that uncollected sales taxes on state and local sales in 2008 totaled approximately $3.9 billion, slightly more than half of what is estimated by the *Fox Study*. Over the course of the five-year period from 2008-2012, our estimates diverge still further from those of the *Fox Study*. For example, the Fox Study estimates uncollected revenues could be as high as $12.7 billion in 2012, compared with our estimate of $4.7 billion. As we explain below, there are three major reasons for the differences between our estimates and those of the *Fox Study*: First, the *Fox Study* substantially overstates uncollected taxes associated with business-to-business (B2B) online sales; second, the *Fox Study* understates tax collections by small firms; third, with respect to "out-year" projections, the *Fox Study* assumes what we regard as an unrealistically high and unsustainable growth rate for online sales, especially considering the fact that the growth of broadband penetration among U.S. households – one of the primary drivers of online sales growth – is slowing as household broadband penetration approaches saturation.

The remainder of this paper is organized as follows. Section II describes our approach and key assumptions, and describes our data set and survey methodology. Section III presents our results for both the baseline (2008) estimate of uncollected taxes and our five-year (2008-2012) forecast. Section IV puts our results in context and briefly discusses policy implications. Section V presents a brief summary of our findings.

## II. Data, Methodology and Assumptions

Our central objective is to estimate the amount of online retail sales made by firms in states where they are not required to collect sales taxes, and then to estimate the taxes not being collected on those sales. To do so, we begin by establishing the size of the overall tax base (i.e., the universe of taxable online sales). Next, we estimate the proportion of sales that occur in states where the seller lacks nexus (and therefore is assumed not to collect sales taxes). Third, we distribute these sales across states, and multiply by the appropriate tax rates. In this section, we describe the data, methodology and assumptions we used in conducting each step. Where appropriate, we note where our approach differs from that adopted in the *Fox Study* and explain why we believe our approach is more appropriate for evaluating alternative sales tax policies.

### A. Estimating the Tax Base

Our first step is to estimate total retail e-commerce sales which are subject to state and local sales and use taxes. The authoritative source of such data is the U.S. Census Bureau, which conducts both monthly and annual surveys of retail trade and, on the basis of those surveys, reports retail e-commerce on both a quarterly and annual basis. Quarterly reports are based on the Monthly Retail Trade Survey (MRTS), and annual reports are based on the Annual Retail

Trade Survey (ARTS).[6] While the Census publishes separate estimates for B2B and B2C e-commerce, its B2C estimates in fact count *all* retail e-commerce, including retail e-commerce involving sales from one business to another.[7] The Census online sales data are also comprehensive with respect to types of sellers, as they include "catalog and mail order operations, many of which sell through multiple channels; 'pure plays' (i.e., retail businesses selling solely over the Internet); and e-commerce units of traditional brick-and-mortar retailers (i.e., 'brick and click')."[8] Thus, we believe the Census Bureau data represents the best estimate of the total amount of e-commerce potentially subject to sales tax, although, as we explain below, there are some reasons to believe it represents an overestimate of the overall tax base. Table 1 below shows the Census Bureau's estimates of retail e-commerce from 1999 through the second quarter of 2009.

**TABLE 1:**
**RETAIL E-COMMERCE 1999-2009 ($BILLIONS)**

| | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008* | 2009** |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **E-Retail Sales** | $15 | $28 | $34 | $45 | $57 | $76 | $87 | $107 | $127 | $133 | $128 |
| **% of Total Retail** | 0.5% | 0.9% | 1.1% | 1.4% | 1.8% | 2.2% | 2.4% | 2.8% | 3.2% | 3.4% | 3.6% |
| **YOY % Change** | - | 86.7% | 21.4% | 32.4% | 26.7% | 33.3% | 14.5% | 23.0% | 18.7% | 4.7% | -3.8% |

*Source: U.S. Census Bureau/E-Stats*
**Based on most recent revised quarterly reports.*
*** Annual rate based on Q1, Q2.*

Our estimate of retail e-commerce differs from the one advanced by the *Fox Study*, which takes a very different approach. For reasons which are not apparent (given that the Census Bureau retail sales data include B2B as well as B2C sales), the *Fox Study* begins by including all

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[6] See http://www.census.gov/retail/mrts/www/data/pdf/09Q2.pdf and http://www.census.gov/econ/estats/2007/2007reportfinal.pdf.

[7] See http://www.census.gov/econ/estats/2007/2007reportfinal.pdf at 2 ("We estimate business-to-business (B-to-B) and business-to-consumer (B-to-C) e-commerce by making several simplifying assumptions: manufacturing and wholesale e-commerce is entirely B-to-B, *and retail and service e-commerce is entirely B-to-C.*")

[8] http://www.census.gov/econ/estats/2007/2007reportfinal.pdf at 3.

e-commerce sales, *including sales classified by the Census Bureau as B2B sales*. These sales have little or no potential for uncollected sales tax, for two reasons: First, wholesale sales or "inputs-to-production" generally are exempt from sales and use taxes.[9] Second, even if some retail sales are captured in the Census Bureau's B2B category, nearly all businesses file and pay the use tax due on their retail purchases, largely because state tax auditors can readily close use tax compliance gaps by examining business records.

Recognizing that its approach is over-inclusive, the *Fox Study* next attempts to exclude some B2B sales, based in part on a survey the authors conducted of state sales tax personnel, who were asked to estimate the proportion of various categories of B2B sales which might be subject to sales tax. Having conducted the survey, however, the *Fox Study* concludes that the results are unreliable, and discards many of the responses in favor of *ad hoc* corrections based on a subset of the data which more closely match the authors' *a priori* expectations.

The ultimate effect of the Fox Study's approach is to inflate the taxable base by including a substantial amount of B2B sales which are not subject to sales and use taxes, and then to apply an *ad hoc* and arbitrary approach to correcting the error.[10] In our view, the entire exercise is both unnecessary and inappropriate: While the Census Bureau data are labeled "B2C," they in fact include *all* retail sales, that is, all sales that are potentially subject to state and local sales and use taxes. There is no valid basis for adding in additional B2B sales.

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[9] For example, the Census Bureau's definition of "wholesale" establishments clearly excludes retailers, yet the *Fox Study* includes sales by such establishments in the tax base for retail commerce. See U.S. Census Bureau, 2002 NAICS Definitions, 42 Wholesale Trade (at http://www.census.gov/epcd/naics02/def/NDEF42.HTM#N42).

[10] The *Fox Study* does not document the methodology by which it arrives at its baseline estimates of the electronic commerce. Moreover, the study provides only an unlabelled bar graph showing historical electronic commerce data, making it impossible to compare the underlying data used in the study to actual data from the Census Bureau. As a result, it is not possible to estimate the precise amount by which the *Fox Study* overstates the tax base.

In fact, there at least three good reasons for believing the Census Bureau retail e-commerce estimates are over-inclusive with respect to taxable sales, even without adding in additional B2B sales. First, the Census Bureau's retail e-commerce data include sales by motor vehicle and parts dealers, which comprise 19 percent ($24 billion in 2007) of total retail e-commerce. Including these sales in the total likely overstates the potential tax base both because automobile sales – regardless of how they are conducted – are subject to taxation at the time of registration, and because many sales of automobile parts are likely B2B sales which are not subject to sales or use taxes in the first instance.

Second, while the Census Bureau data exclude online travel services, financial brokers and ticket sales agencies, they include sales of at least three types of items – food, clothing, and intangibles (e.g., downloaded software,) – which often are not subject to sales tax. The *Fox Study* attempts, through its survey of state finance department personnel, to estimate the proportion of B2C sales that are subject to taxation, and ultimately concludes that about 30 percent of B2C sales are exempt from sales and use taxes. While we agree that many B2C sales are not taxable, we do not believe the *Fox Study's* survey results are sufficiently reliable to form the basis for such a precise estimate.

Third, to the extent the Census Bureau data include B2B sales, it is likely that the purchasing businesses pay use taxes on purchases for which sales tax is not collected by the seller. Past research suggests that the use tax compliance rate among businesses is between 85 and 100 percent.[11]

We considered various approaches to adjusting for these issues of over-inclusion, including – for example – excluding e-commerce sales by automobile dealers, supermarkets and

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[11] *See e.g.*, Johnson at 6.

online music services), but we ultimately chose not to make such adjustments because we lack the underlying data needed to do so with precision. As a result, our estimate of the overall retail e-commerce tax base is likely to be significantly above the true amount, meaning that our estimates of uncollected taxes are likely also biased upwards relative to the actual amount.

**B. Establishing Nexus**

The second step in our analysis is to ascertain the extent to which sales taxes are already being collected on retail e-commerce sales, that is, to determine the extent to which retail e-commerce involves sales to customers in states where the seller has nexus or is, for whatever reason, collecting sales taxes.[12] To do so, we began by researching the firms listed in the 2009 edition of *Internet Retailer Top 500 Guide*, which provides data on 2008 retail e-commerce sales by the largest online retailers, or all those with annual online sales exceeding $9 million.[13] Specifically, for 250 of the 495 U.S. firms listed in the guide,[14] we ascertained the states in which each firm collected sales taxes on online sales. For each firm, we followed the following sequence: First, we visited the firm's website and searched for a listing of states in which tax was collected; second, if the website data was inconclusive, we contacted the firm's customer service department; third, if customer service was unable or unwilling to provide the information, we

[12] As we discuss further below, "nexus" is an inexact and evolving concept. For example, New York has recently passed legislation defining nexus as including a situation where an online retailer has sales affiliates in the state (e.g., an Amazon advertising partner). Amazon has sued the state over this law, and is collecting sales tax on sales to New York residents, pending the outcome of its lawsuit.

[13] Information on the *Guide* is available at www.internetretailer.com/top500.

[14] Five firms are Canadian and thus not subject to U.S. sales taxes or included in the U.S. Census Bureau data. Of the remainder, we surveyed each of the top 150 firms and bottom 50 firms, and an additional 50 firms ranked between 150 and 450.

researched the firm's website, its Securities and Exchange Commission filings, and other public data, for a list of states in which the firm in has a retail store or other physical presence [15]

Several findings from this portion of our analysis are worth highlighting. First, there is an extremely wide variance in the number of states where firms collect taxes. For the top 150 *Internet Retailer* firms, for example, 77 collect in 10 states or fewer, and 62 collect in 30 or more; only 11 collect in 11 or more states but fewer than 30. This bi-polar distribution reflects the distinction between "pure play" retailers (such as Amazon.com) which have nexus in very few states, and "brick and click" retailers (such as Staples) which collect taxes in most or all states. As shown in Table 2, most of the largest online retailers (ranked by 2008 U.S. online sales) are "brick and click" firms which collect taxes in most or all of the states with sales taxes.

[15] When no determination could be made, we assumed that the firm in question *did not* collect sales taxes in any state. Our approach was similar to that used by the *Fox Study*, though their data was based on the 2007 edition of *Internet Retailer*, and they surveyed only 100 firms (the top 50 plus 50 more chosen at random). See *Fox Study* at 20. Note that, like the Census Bureau data, the *Internet Retailer* guide excludes online travel agents and brokerages, but includes several categories of sellers (e.g., music and game download sites, grocery stores) whose sales are likely largely exempt from sales taxes.

**TABLE 2:**
**STATES WHERE SALES TAXES ARE COLLECTED, TOP 20 E-RETAILERS**

| Firm | 2008 Online Sales | States Where Taxes Are Collected |
|---|---|---|
| Amazon.com[16] | $10,228,000,000 | 5 |
| Staples | $7,700,000,000 | 44 |
| Dell | $4,830,000,000 | 47 |
| Office Depot | $4,800,000,000 | 47 |
| Apple | $3,642,118,080 | 47 |
| OfficeMax | $3,083,730,683 | 47 |
| Sears Holdings | $2,693,433,600 | 47 |
| CDW | $2,600,122,100 | 47 |
| Newegg | $2,100,000,000 | 3 |
| Best Buy | $2,015,183,282 | 47 |
| QVC | $1,993,361,800 | 47 |
| SonyStyle.com | $1,827,577,534 | 47 |
| Walmart.com | $1,740,000,000 | 47 |
| Costco | $1,700,000,000 | 38 |
| J.C. Penney Co. | $1,500,000,000 | 47 |
| HP Home & Home Office Store | $1,497,000,000 | 47 |
| Circuit City Stores * | $1,414,000,000 | 29 |
| Victoria's Secret | $1,333,000,320 | 45 |
| Target | $1,209,208,320 | 46 |
| Systemax | $1,072,071,000 | 5 |

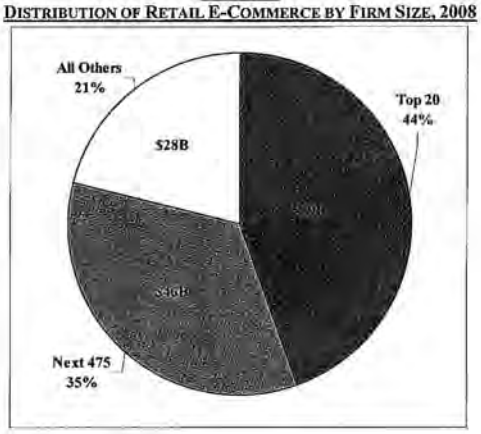
*Source: Internet Retailer*
**Circuit City Stores went through Chapter 7 in 2008*
*Note: While it does not have a state sales tax, we count Alaska as a sales tax state, given that multiple local jurisdiction levy sales and use taxes.*

Second, as shown in Figure 1, the distribution of e-retail sales is heavily skewed towards the largest retailers. Overall, we found that the top 20 internet retailers accounted for nearly $59 billion in 2008 sales (44 percent of the $133 billion total), and the top 495 firms accounted for approximately $105 billion in sales, or 79 percent of all sales. The remaining retail e-commerce

[16] We adjusted Amazon's total sales to reflect the fact that approximately 47 percent of its $19 billion in sales (about $9 billion) are made outside the United States. See Amazon.Com, Inc., *Form 10-K for the Fiscal Year Ended December 31, 2008* at 30.

sales ($28 billion) are associated with smaller firms, i.e., those with less than $9 million in online sales.[17]

FIGURE 1:
DISTRIBUTION OF RETAIL E-COMMERCE BY FIRM SIZE, 2008




## C. Apportioning Sales Among States

Uncollected tax revenues in any given state are the product of online sales in the state upon which taxes are not collected and the applicable tax rate. Thus, the next step in our analysis is to apportion each company's sales among the states. We do so by assuming that individual firm e-commerce revenues are distributed across the 50 U.S. states (and Washington D.C.) in the

[17] As we discuss further below, the *Fox Study* cites a recent draft working paper which argues that the Census Bureau data underestimates sales by small firms. (*See* Joe Bailey *et al*, "The Long Tail is Longer than You Think: The Surprisingly Large Extent of Online Sales by Small Volume Sellers," Draft, University of Maryland, May 12, 2008.) While a complete critique of that paper is beyond the scope of this study, it is clear that it suffers from numerous methodological problems which make its results unreliable. (To cite just one example, the Bailey paper relies on comScore data on web sales by the top 140 online retailers (with average annual online sales of *$675 million*) to estimate sales by firms with sales *below $1 million*.) While the *Fox Study* relies on the Bailey paper to estimate the distribution of sales by firm size, it does not embrace the Bailey paper's contention that the Census Bureau underestimates overall e-commerce sales and does not rely on the Bailey paper for its estimate of total online sales.

same proportions as overall 2008 total retail sales, as reported by the Census Bureau. That is, for example, if a particular state accounts for five percent of retail commerce in the United States, we attribute five percent of each firm's online sales to that state.[18]

We considered other approaches to apportioning sales across states. The *Fox Study*, for example, apportions sales on the basis of total state and local sales tax collections, thus weighting sales towards states with higher tax rates. The authors defend this approach on the basis of studies which show that consumers in high tax states are more likely to shop online than consumers in low tax states, presumably to avoid paying sales taxes.[19] One problem with this approach is that tax rates are only one of many factors that affect the geographic distribution of online sales, including (for example) the proximity of the retailer to the buyer,[20] and demographic factors such as personal income, Internet penetration and broadband adoption.[21] Thus, while there is some evidence that people in high tax states are more likely to shop online *other things equal*, there is no evidence we are aware of that suggests that differences in tax rates explain a significant portion of the variation in online retail sales across states. Moreover, we suspect one of the strongest determinants of the distribution of firm sales across states is domicile – that is, given the growing significance of "brick and click" retailing, we suspect many retailers' online sales are concentrated in states where customers can visit their affiliated retail stores to preview items and seek the convenience of returning or exchanging items they have

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[18] We deviated from this method in the case of only three firms in our sample: Peapod, Safeway, and FreshDirect. These three firms are brick and click grocers with very specific areas of operations. We contacted these firms and determined the states in which they provide their online grocery service and applied their total online sales, as listed in *Internet Retailer*, only to those states.

[19] *See,* c.g., Austan Goolsbee, 2000. "In a World Without Borders: The Impact of Taxes on Internet Commerce," *Quarterly Journal of Economics* 115;2 (May 2000) 561-576..

[20] See, e.g., Glenn Ellison and Sara Ellison. "Internet Retail Demand: Taxes, Geography, and Online-Offline Competition," (Massachusetts Institute of Technology Department of Economics Working Paper Series, May 2006).

[21] See e.g., John Horrigan, *Online Shopping* (Pew Project on the Internet and American Life, February 2008) (available at http://www.pewinternet.org/Reports/2008/Online-Shopping/01-Summary-of-Findings.aspx?r=1).

purchased online. This phenomenon which would tend to work against the *Fox Study's* bias of allocating more sale to high-tax states. In the end, rather than introducing spurious (or even biased) variation into our data set (as we believe the approach taken by the *Fox Study* does), we elected to simply apportion online sales according to overall retail sales.

## III. ESTIMATES OF UNCOLLECTED TAXES

The next steps in our analysis are to calculate estimates of uncollected taxes for 2008, based on the estimates of underlying variables discussed above, and then to forecast uncollected taxes into the future, i.e., for the period from 2009-2012.

### A. Uncollected Revenues in 2008

To estimate uncollected revenues for 2008, we begin by estimating uncollected revenues for the large firms covered in the *Internet Retailer* report, and then add an estimate for smaller firms (those with revenues below $9 million). We note, however, that the estimate for smaller firms is, in a sense, less significant, as there appears to be general agreement that the administrative costs of collecting from smaller firms is much higher than for larger firms (For example, a survey commissioned by the Streamlined Sales Tax Project found that firms with annual retail sales of between $150,000 and $1 million incur collection costs averaging 13.5 cents for every dollar of sales tax they collect.[22]), and that even if larger firms were to be required to collect taxes on out-of-state sales, smaller firms would be exempted.

To estimate uncollected revenues for large firms, we multiplied state-specific retail e-commerce revenues for each firm by the applicable sales tax rates for each state.[23] Thus, for

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[22] See PriceWaterhouseCoopers, *Retail Sales Tax Compliance Costs: A National Estimate* (April 7, 2006) at 18 (available at http://www.netchoice.org/library/cost-of-collection-study-sstp.pdf ).

[23] We utilized the same source for sales tax rates as in the Fox Study, namely the Sales Tax Clearinghouse. Rates represent statewide rates plus local tax rates divided by the state sales tax base, i.e., they represent blended state and local sales tax rates for each state. See http://www.thestc.com/STrates.stm.

each firm, we calculated the amount of taxes that would be owed in each state, if the firm had nexus in that state. Next, for each firm, we sum this amount across all states in which the firm does not collect sales taxes. As shown in Table 3 below, the total for the top 150 firms in 2008 was $1.985 billion; for the bottom 50 firms, the total was $27 million. For the middle group of 300 firms, we first calculated the average ratio of taxes collected to potential taxes due for the 50 firms whose tax collection practices we sampled from this group, and applied this ratio to all 300 firms. On that basis, we estimate the total for the 300 middle firms at $418 million.

The last step in our analysis was estimate the ratio of taxes collected to potential taxes for smaller firms, or those not included in the *Internet Retailer 500* survey. As noted above, we estimate these firms constitute approximately 21 percent (or $28 billion in 2008) of retail e-commerce sales.

We considered but rejected the approach adopted in the *Fox Study*, which was to simply assume extremely small tax compliance rates for small firms. Specifically, the *Fox Study* assumes, without any empirical basis, that "medium-sized firms" (those with online revenues of less than $10 million) pay taxes only in their home states, and thus (dividing 1 by 50) the *Fox Study* assigns these firms a two-percent compliance rate – even if their home state is California; and, it assumes that "small" firms (online revenues less than $1 million) only pay half of the taxes due even in their home states (on average), and hence have a compliance rate of one percent. In our view, these assumptions are arbitrary and unsupportable, and at odds with our research on states where the top 500 e-retailers already collect sales tax.

We believe the *Fox Study* errs in this regard primarily by assuming (or seeming to assume) that all or almost all firms with relatively low online sales fit some combination of two criteria: (a) they are exclusively or almost exclusively "pure play" online retailers, with few if

any brick and mortar retail outlets; or (b) they are small firms that lack rigorous tax compliance programs, and/or are not subject to tax audits by state governments. This characterization, however, simply does not comport with the data. While some firms with small online revenues meet these criteria, others are actually large, multi-state brick-and-click retailers that collect taxes in multiple jurisdictions. For example, both Hancock Fabrics and Sur La Table have less than $10 million in online sales, as reported by Internet Retailer. Yet, Hancock Fabrics collects taxes in 36 states, and on 92 percent of its sales, while Sur La Table collects taxes in 21 states, and on 73 percent of its sales. To assume, as the *Fox Study* does, that both of these firms collect taxes on only two percent of sales clearly biases upward their estimate of uncollected sales tax.

Upon examination of the data, we found only a weak correlation between online sales revenues and the proportion of taxes collected. Accordingly, we assumed that the ratio of taxes collected to potential tax collections for smaller firms (those with revenues less than $9 million) is the same as for the "bottom 50" firms in the Internet Retail 500 (firms with online sales of between $9 million and $11.8 million in 2008 online sales), or approximately 26 percent. On that basis, as shown in Table 3, we estimate uncollected taxes among these firms at less than $1.5 billion, assuming no *de minimis* exemption.

**TABLE 3:**
**RETAIL SALES AND POTENTIAL UNCOLLECTED TAXES, BY FIRM SIZE, 2008**

| Size Category (Ranked by 2008 E-Retail Sales) | e-Retail Sales ($millions) | Potential Uncollected Sales Tax ($millions) |
|---|---|---|
| Large (Top 150) | $95,145 | $1,985 |
| Middle (Next 300) | $9,351 | $418 |
| Small (Bottom 50) | $514 | $27 |
| *Subtotal (Internet Retailer 500)* | *$105,010* | *$2,430* |
| Micro (Sales under $9 million) | $27,990 | $1,477 |
| **Total** | **$133,000** | **$3,907** |

As the table indicates, summing across these four classes of firms, we estimate total uncollected revenues for 2008 at $3.9 billion.

The last step is to estimate the impact of applying a *de minimis* exemption. As noted above, even proponents of overturning *Quill* recognize that the administrative burdens placed on small sellers (and tax collection agencies) would be very high relative to the amount of taxes collected; and, since some proposals contemplate reimbursing businesses for the collection charges, at least some of those collection costs would have the effect ultimately of reducing net tax collections, thus defeating the purpose altogether. Accordingly, most proposals would create a small business exemption which, for example, would exempt all firms with gross remote (i.e., out-of-state) sales of less than $5 million.[24]

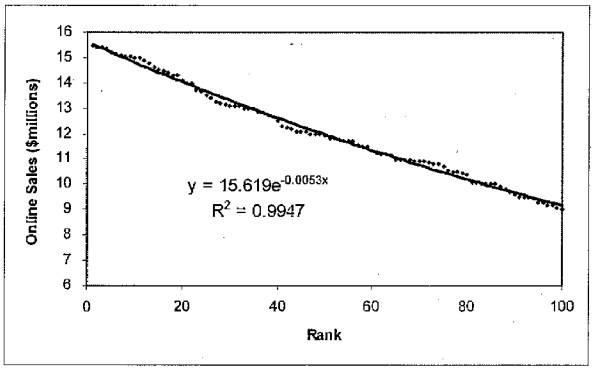
To estimate the impact of such an exemption, we first estimated the amount of remote sales for each firm on the *Internet Retailer 500* list. Then, for firms with less than $5 million in remote sales, we summed our firm-specific estimates of uncollected sales taxes across the firms with less than $5 million in sales. We identified 39 firms out of the top 500 that (a) had less than

[24] See, e.g., H.R. 3184, 108th Congress, 1st Session, Sec. 4(b).

$5 million in remote sales and (b) did not collect taxes in one or more states.[25] The estimated uncollected taxes for these 39 firms totaled only $4 million.

To assess the impact of a $5 million exemption for those retailers which are not on the *Internet Retailer 500* list, we first estimated the shape of the size distribution (based on online sales) for smaller firms. To do so, we fitted an exponential curve (i.e., a regression equation) based on the bottom 100 firms in the *Internet Retailer 500*, and used the regression coefficients to estimate the sales revenues of the next 500 firms. The results of the regression analysis are shown in Figure 2, which demonstrates that our regression model is an excellent fit, with the R-squared statistic indicating we have explained approximately 99 percent of the variation in firm size over the relevant range.

**FIGURE 2:**
**REGRESSION ANALYSIS OF FIRM SIZE**




[25] Note that these firms include both "large" and "small" firms as ranked by overall sales, since the criterion for exemption is that a firm have less than $5 million in *remote* sales.

The results of applying the regression coefficients in Figure 2 to estimate the size of the "next 500" online retailers are shown in Table 4. As the table indicates, the bottom 500 firms on the *Internet Retailer 500* list (firms ranked 401-500) have average e-commerce sales of $12.1 million; the next 100 (ranked 501-600) have estimated average sales of $7.2 million; the next 100 (601-700) have estimated average sales of $4.1 million, and so forth.

**TABLE 4:**
**ESTIMATED RETAIL E-COMMERCE SALES BY FIRM SIZE**

| Firm Rank | Total e-Commerce Sales | Average e-Commerce Sales |
|---|---|---|
| 401-500 | $1,208,032,677 | $12,080,327 |
| 501-600 (est.) | $717,102,300 | $7,171,023 |
| 601-700 (est.) | $413,539,010 | $4,135,390 |
| 701-800 (est.) | $243,411,117 | $2,434,111 |
| 801-900 (est.) | $143,272,993 | $1,432,730 |
| 901-1000 (est.) | $84,977,289 | $849,773 |
| Total (501-1000) (est.) | $1,602,302,708 | $3,204,605 |

One important implication of the data in Table 4 is the fact that estimated retail e-commerce sales for the "second 500" – firms ranked 501-1000 in online sales – total only about $1.6 billion annually, accounting for only 5.7 percent of the $28 billion in online sales we attribute to firms with less than $9 million in sales, based on the Census Bureau and *Internet Retailer* data. Thus, our estimates are consistent with the notion that there is indeed a "long tail" of small online retailers, for example, a tail consisting of five million sellers averaging $5,280 in online sales per year, or a total of $26.4 billion for all firms outside the top 1000.[26]

To assess the impact of a small business exemption on this group of firms, we assumed that small retailers had the same ratio of in-state to out-of-state sales as the bottom 50 in the

*Internet Retailer* list (that is that remote sales accounted for 74 percent of total sales), and on that basis estimate that firms with more than $6.76 million in online sales (= $5 million/0.74) would be required to collect sales taxes and all others would be exempt. There are 58 such firms, with estimated remote sales revenues of $339 million. Applying the national average tax rate (7.13%) to these sales yields potential uncollected revenues from these firms of approximately $24 million.

With these estimates in hand, we can now calculate the impact of a $5 million small business exemption. We begin with our total estimate of potential uncollected revenues of $3.9 billion, which includes $2.4 billion from the top 500 firms and $1.5 billion from all other firms. As explained above, we estimate that a small business exemption would reduce collections from the top 500 firms by only $4 million. For all other firms it would reduce collections by $1.477 billion minus $24 million, or $1.453 billion. Thus, for 2008, we estimate a small business exemption would reduce potential collections by a total of $1.457 billion. Accordingly, we estimate that the maximum amount of additional revenue that would result from overturning *Quill*, assuming a small business exemption is adopted, is $2.45 billion.[27]

**B. Forecast of Uncollected Revenues, 2009-2012**

We developed two forecasts for uncollected revenues for the period 2009-2012. The first (baseline) forecast is based on the projected growth of online sales over this period, assuming all other variables remain unchanged. The second (adjusted) forecast is based on the assumption

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[26] Indeed, projecting our results to the next 1,000 firms suggests the average online sales of firms ranked 1001-2000 are only $120,000, with the 2000th firm having less than $35,000 in sales; total sales in this group are only about $120 million.

[27] The *Fox Study* also calculates the effect of a *de minimis* exemption. While it takes a very different approach (for example, it appears to base its exemption thresholds on total online sales rather than remote online sales), the effect is, coincidentally, entirely consistent with our estimate: Both methods find that a $5 million *de minimis* exemption would reduce collections by 37 percent of total uncollected revenues.

that current trends with respect to collection rates continue – that is, that the proportion of online sales for which firms collect and remit state and local sales taxes continues to increase.

To arrive at our baseline projection, we estimated a simple model of the level of retail e-commerce, variations in which we hypothesize can be explained by (a) overall retail sales and (b) the level of household broadband penetration. Accordingly, we collected data quarterly data on retail e-commerce, total retail commerce, and broadband penetration from 2000 through 2009. We acquired the e-commerce data and total retail commerce data from the Census Bureau's Quarterly E-Commerce Reports.[28] We acquired household broadband penetration data from the Pew Internet & American Life Project's Broadband at Home Survey.[29] Using these data, we specified a regression model where retail e-commerce was the dependent variable and total retail commerce and broadband penetration were the independent variables. Table 5 depicts the results of this analysis:

**TABLE 5:**
**REGRESSION ANALYSIS OF RETAIL E-COMMERCE**

| Variable | Coefficient | T-Stat | P-Value |
|---|---|---|---|
| **Constant** | 17396.6 | 3.47 | 0.00 |
| **Retail Commerce** | 0.029 | 4.45 | 0.000 |
| **Broadband Penetration** | 37110.7 | 11.54 | 0.000 |
| ***Adjusted R-Squared*** | *0.95* | | |
| ***Observations*** | *38* | | |

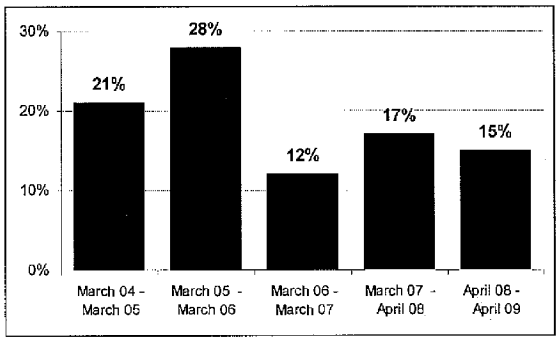
[28] U.S Census Bureau, *Quarterly Retail E-Commerce Sales*, Q1 2000 - Q2 2009. We note that data for prior years are often restated in subsequent reports. In these cases, we used the data reported in the most recent available E-commerce report.

[29] Pew Internet & American Life Project, *Broadband at Home, 2000-2009*. The Pew survey data is reported in different months across different years. Thus, we used a two step algorithm to match the Pew broadband survey data to the census bureau's quarterly e-commerce reports. First, we looked to see if for each quarter there was a survey date that was within that quarter. If there was we assigned that value to the quarter. If there were two surveys within a quarter, we assigned the later survey date. For quarters that were missing survey data, we used the value of the *next* quarter with available data.

As the data in Table 5 indicate, our two-variable regression analysis explains approximately 95 percent of the variation in retail e-commerce over the nine-year period. Regression coefficients on both of the explanatory variables are, as expected, positive, and t-statistics indicate that they are significantly different from zero at a confidence level of greater than 99 percent. In short, our model is statistically robust and explains nearly all of the variation in retail e-commerce over the sample period.

We then used this model to forecast retail e-commerce sales for each quarter from Q2 2009 to Q4 2012, using forecasted broadband growth data from Gartner Research and forecasted nominal GDP growth data from the Congressional Budget Office (CBO). With respect to broadband adoption, our forecasts – from the Gartner Group – are consistent with the slowing growth of broadband penetration in recent years. For example, the latest data from the Pew Project on the Internet and American Life, shown in Figure 3, shows that the average annual growth in broadband penetration has fell by nearly 50 percent between 2005-6 and 2008-9, from 28 percent to only 15 percent.

FIGURE 3:
GROWTH IN BROADBAND PENETRATION, 2004-2009[30]




Specifically, we based our estimates of broadband penetration on forecasts from Gartner Research, which predicts that U.S. household broadband penetration in 2012 will be 77 percent.[31] Thus, for the purposes of projecting broadband growth we assigned Gartner's penetration estimate of 77 percent to Q4 2012, and allocated the difference between this final projection and Pew's Q2 2009 survey estimate of 63 percent linearly across the remaining quarters.

To project total Retail Commerce through Q4 2012 we simply grew total retail commerce in each quarter by the nominal GDP growth rate projected by the CBO relative to the same quarter in the previous year.[32] Thus, Q3 2009 would simply be total retail sales in Q3 2008 plus the projected 2009 CBO growth rate times total retail sales in Q3 2008. Our projections for 2009-2012 are shown in Table 6 below.

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[30] Source: Pew Project on the Internet and American Life.

[31]. Gartner Research, *Gartner Says 17 Countries to Surpass 60 Percent Broadband Penetration into the Home by 2012*, Jul. 24, 2008, *available at* http://www.gartner.com/it/page.jsp?id=729907 (Last visited Aug. 31, 2009).

**TABLE 6**
**RETAIL E-COMMERCE BASELINE FORECAST, 2008-2012 ($BILLIONS)**

| | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|
| **Retail Commerce** | | | | | |
| **Level** | $3,973 | $3,726 | $3,834 | $3,988 | $4,199 |
| **YOY % Change** | | -6.2% | 2.9% | 4.0% | 5.3% |
| **Broadband Penetration** | | | | | |
| **Level*** | 57.3% | 63.8% | 67.5% | 71.5% | 75.5% |
| **YOY % Change** | | 11.3% | 5.8% | 5.9% | 5.6% |
| **Retail E-Commerce** | | | | | |
| **Level** | $133 | $131** | $142 | $152 | $164 |
| **YOY % Change** | | -1.5% | 8.4% | 7.0% | 7.9% |

** Note that annual BB penetration represents the average value for the year based on our estimates derived from Pew and Gartner.*
***Note that this figure differs from the 2009 value given in Table 1 because the retail e-commerce figure listed in this table was predicted based on our model's estimates for Q3 and Q4, 2009, while in Table 1 the 2009 projection was created by multiplying the sum of e-retail sales in Q1 and Q2, 2009 by two. The close proximity of the two values serves as a good robustness check on accuracy of our model.*

Table 7 compares our projections for e-commerce growth with those used in the *Fox Study*. Our projections vary substantially, but we believe appropriately, from those advanced in the *Fox Study*, which projects dramatically higher growth in retail e-commerce.

**TABLE 7:**
**COMPARISON OF FOX VS. EISENACH-LITAN PROJECTED E-RETAIL GROWTH RATES**

| | 2008 | 2009 | 2010 | 2011 | 2012 | CAGR (2008-2012) |
|---|---|---|---|---|---|---|
| **Fox Baseline** | 6.6% | -10.0% | 24.0% | 17.6% | 12.4% | 10.2% |
| **Fox Optimistic** | 6.9% | -3.1% | 32.2% | 14.1% | 11.7% | 13.0% |
| **Eisenach-Litan** | 3.9%* | -1.3% | 8.4% | 7.3% | 7.9% | 5.5% |

**Actual, as reported by Bureau of the Census, E-Stats*

The *Fox* estimates are based on a regression model which the authors develop by "regressing the log of e-commerce shipments on the log of nominal GDP and the real GDP

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[32] Congressional Budget Office, *Table 2.1: CBO's Economic Projections for Calendar Years 2009 to 2019, available at* http://www.cbo.gov/doc.cfm?index=10521 (Last visited Aug. 31, 2009).

growth rate for 1999 through 2006," and then applying projections for GDP growth from a private forecaster, Global Insight, to forecast e-commerce from 2007 through 2012. The result, as shown in Figure 4, is a "hockey-stick" shaped forecast, with a dramatic and unexplained surge in growth in 2010 and beyond. We find no basis for projecting such high growth rates into the future, especially given the slowdown in broadband penetration growth, which effectively limits the growth of "new shoppers" entering the online marketplace.[33]

Applying our projected growth rates to our baseline estimate of $3.9 billion in uncollected 2008 revenues, and assuming no other changes in the makeup of online sales, tax policy, or otherwise, we estimate potential uncollected revenues for the period 2008-2012 will average approximately $4.24 billion annually. Assuming enactment of a small business exemption, however, reduces the figure to an average of $2.67 billion annually. As shown in Table 8, our estimates are substantially less than the *Fox Study's* forecasts over the same period.

**TABLE 8:**
**COMPARISON OF EISENACH-LITAN VS. FOX PROJECTED UNCOLLECTED TAXES**
**($BILLIONS, 2008-2012)**

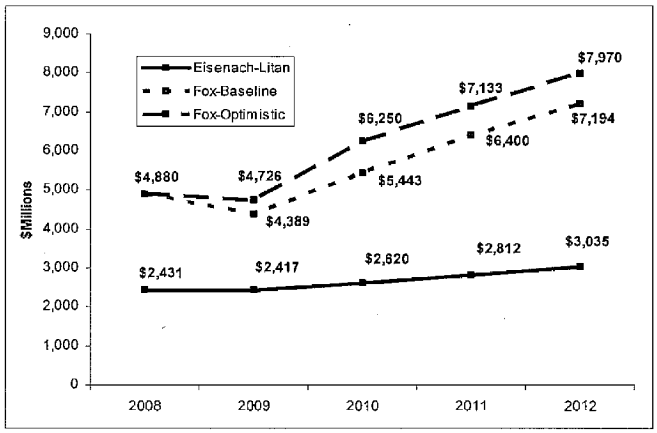
| | 2008 | 2009 | 2010 | 2011 | 2012 | Average |
|---|---|---|---|---|---|---|
| Without Small Business Exemption | | | | | | |
| **Eisenach-Litan** | $3.91 | $3.85 | $4.17 | $4.48 | $4.83 | $4.25 |
| **Fox Baseline** | $7.73 | $6.95 | $8.62 | $10.14 | $11.39 | $8.97 |
| **Fox Optimistic** | $7.75 | $7.50 | $9.92 | $11.32 | $12.65 | $9.83 |
| With Small Business Exemption | | | | | | |
| **Eisenach-Litan** | $2.45 | $2.42 | $2.62 | $2.81 | $3.04 | $2.67 |
| **Fox Baseline** | $4.88 | $4.39 | $5.44 | $6.40 | $7.19 | $5.66 |
| **Fox Optimistic** | $4.88 | $4.73 | $6.25 | $7.13 | $7.97 | $6.19 |

[33] We also note that the *Fox Study* authors have dramatically overestimated e-commerce growth rates in their previous studies. See, e.g., Johnson at 2.

The differences in these projections are both quantitative and qualitative in nature. As shown in Figure 5, the *Fox Study* – based on its "hockey stick" forecast for the growth of electronic commerce – forecasts that uncollected tax revenues will grow rapidly in the future. Our forecast, which is based on what we believe to be a far more realistic forecast for e-commerce growth, shows uncollected revenues growing only modestly. Indeed, our five-year forecast shows *nominal* uncollected revenues growing at only about 5.2 percent per year, only slightly higher than recent inflation rates – that is, in real terms, uncollected revenues are growing very slowly, if at all. Perhaps most importantly, our estimates show uncollected revenues – assuming no changes in either state tax collection policies or in the makeup of online sales – remaining nearly constant as a proportion of state and local revenues, remaining below 0.22 percent (one quarter of one percent) of total state and local revenues, and below one percent of sales and use tax revenues, throughout the projection period.[34]

[34] These ratios assume state and local taxes grow at the same rate as Gross Domestic Product throughout the period, i.e., at the same rate assumed in our e-commerce forecast for total retail sales.

FIGURE 5:
POTENTIAL UNCOLLECTED REVENUE FORECASTS, 2008-2012
(ASSUMING *DE MINIMIS* EXEMPTION)




## IV. DISCUSSION AND IMPLICATIONS

Our results have several important policy implications.

Most importantly, our results suggest that uncollected sales taxes are much smaller than previously thought, and that they are growing, if at all, at a much slower rate. Indeed, two factors we have not yet mentioned suggest uncollected sales tax revenues are likely to fall over time, at least as a proportion of all taxes. First, there is some evidence that the online sales of the brick–and-click retail model are growing more rapidly than those of "pure play" purveyors such as Amazon.com. For example, according to a survey conducted by the LakeWest Group, nearly three quarters of the top 100 retailers have embraced multichannel retailing and that "[o]f retailers who operate websites, 60 percent have at least some integration between store and Web

site, and more than half allow returns to cross channel."[35] To confirm this trend, we analyzed the growth of sales by "pure play" versus "brick and click" retailers in the *Internet Retailer 500* list, and found that firms that paid taxes on more than 50 percent of their online sales did indeed grow faster between 2007 and 2008 than firms that paid taxes on less than 50 percent of their online sales. These results are consistent with other research suggesting that online sales growth is occurring most rapidly among firms that collect sales taxes on large proportions of their sales. Johnson, for example, concludes that "the future of Internet growth has been shown to be in multi-channel, clicks and bricks,"[36] citing studies performed by Forrester Research that demonstrate "consumers' desire to couple 'clicks'-based shopping with 'bricks'-based merchandise pick-ups and returns."[37] Thus, there are strong reasons to believe that the proportion of online commerce associated with out-of-state sales is falling and will continue to fall over time.

Second, states are not standing still waiting for *Quill* to be overturned, but instead are moving aggressively to use the tools at their disposal. For example, in April 2008, New York State passed legislation asserting nexus for any retailer that has sales affiliates in the state that generate a combined total of $10,000 or more annually in revenues for the retailer.[38] In 2009, at least two state legislatures (Rhode Island and North Carolina) have enacted laws that assert nexus when remote retailers compensate in-state websites for displaying the retailer's advertisements.[39] In July 2009, California Governor Arnold Schwarzenegger signed legislation

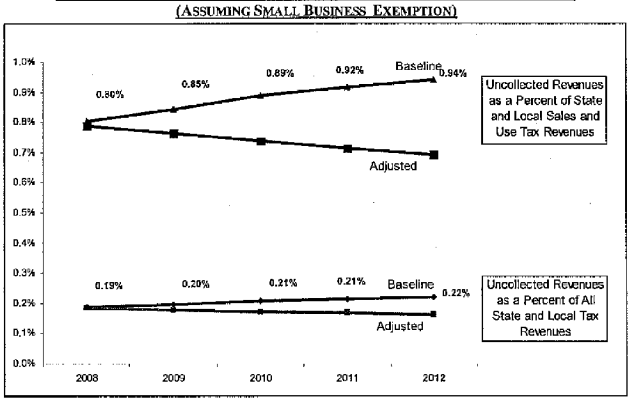
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[35] See Hamilton at 4.
[36] Johnson at 6.
[37] *Id.*
[38] See Hamilton at 5.
[39] See North Carolina GEN. STAT. § 105-164.8, as amended 7-Aug-2009. See also North Carolina Department of Revenue, Form E-505 (9-09) at 2-3 (available at at http://www.dornc.com/downloads/e505_8-09.pdf), and Rhode Island Division of Revenue, Department of Taxation, "Important Notice: Definition of Sales Tax 'Retailer' Amended" (available at http://www.tax.state.ri.us/notice/Retailer_definition_NoticeC.pdf).

to improve business compliance with the state's use tax. The California Board of Equalization estimated the new legislation, along with ongoing measures aimed at shrinking the "tax gap," would reduce uncollected revenues from businesses by over 60 percent in the next two years.[40] Furthermore, in recent years, some states have used their leverage as large purchasers to force sales tax collection by online retailers.[41]

Taken together, these two factors suggest that, rather than growing very slowly, as our uncorrected baseline estimates suggest, uncollected sales tax revenues may actually be declining as a proportion of state and local tax revenues, as illustrated in Figure 6 below.

**FIGURE 6:**
**POTENTIAL UNCOLLECTED REVENUE AS A PROPORTION OF STATE AND LOCAL TAX COLLECTIONS, 2008-2012**
**(ASSUMING SMALL BUSINESS EXEMPTION)**




[40] State of California, Board of Equalization, *Electronic Commerce and Mail Order Sales* (November 3, 2009) (available at http://www.boe.ca.gov/legdiv/pdf/e-commerce-11-09.pdf). The Board of Equalization estimates uncollected revenues in 2012 at $1.0 billion, far below the *Fox Study's* baseline estimate of $1.9 billion.

[41] See, e.g., Institute for Local Self-Reliance, "Internet Sales Tax Fairness - State Purchasing Provision - North Carolina" (available at http://www.newrules.org/retail/rules/internet-sales-tax-fairness/internet-sales-tax-fairness-state-purchasing-provision-north-carolina).

A second implication of our research is to provide some support for those who have suggested imposing a collection obligation on only those e-retailers with the highest amounts of uncollected sales tax. Our analysis of 2008 data shows that the ten firms with the largest amounts of uncollected taxes account for 47.3 percent of all uncollected taxes for the *Internet Retailer 500* e-retailers, and 46.9 percent of uncollected revenues for all firms not subject to a $5 million small business exemption.

## V. CONCLUSIONS

Taxation of remote sales is a hotly debated issue, and as states and localities experience the fiscal stresses associated with the current economic downturn, it is not surprising to hear renewed calls for overturning *Quill* and forcing e-retailers to collect taxes on out-of-state sales. However, a decision to impose such an mandate would have costs as well as benefits. The costs would include increased compliance costs for businesses, increased administrative costs for tax collection agencies, higher vendor compensation payments, and, of course, higher taxes for price-sensitive consumers who rely on online shopping. On the other side of the scale, state and local tax collections would increase. From the perspective of state and local governments, the relevant question is whether the increase in collections would more than outweigh the higher costs. Our research suggests that the increased collections associated with overturning *Quill* would be substantially lower than previously thought – approximately $2.5 billion annually rather than the $7 billion or more estimated in the *Fox Study*. Moreover, our analysis shows that uncollected taxes are not growing rapidly and, indeed, are likely constant or even shrinking as a proportion of state and local tax revenues. With this data in mind, policymakers should consider carefully whether the benefits of overturning *Quill* would exceed the costs.

APPENDIX: STATE-BY-STATE ESTIMATES OF POTENTIAL UNCOLLECTED REVENUE

In addition to the national estimates presented in the text, we also estimated potential uncollected revenues on a state-by-state basis. As explained in the text, our survey of firms' tax collection practices in each state allowed us, for the firms surveyed, to directly estimate uncollected taxes on a firm-by-firm basis. (Indeed, our national estimates for these firms represent the summation of uncollected taxes across states and firms.) For firms not surveyed, i.e., un-surveyed firms from the *Internet Retailer 500* and firms in the "tail," we estimated potential uncollected revenues though a two-step process. First, we applied our sampling methodology for estimating the taxes avoided for the middle 300 *Internet Retailer* firms on a state-by-state basis.[42] The reason for applying this state-by-state method was that it allowed for variation in each state's ratio of sample avoided taxes to sample total taxes, creating a more accurate portrayal of the each state's estimated avoided taxes. Adding the estimated avoided taxes for the middle 300 firms to the avoided taxes for the top 150 and bottom 50 firms within each state yielded the total avoided tax for the top 500 internet retailers in each state. Second, we then distributed the avoided taxes attributable to firms in the "tail" by allocating the total estimated avoided taxes for firms in the tail on a pro-rata basis according to each state's proportion of taxes avoided by the top 500 internet retailers.

Having arrived at baseline estimates for 2008, we next calculated an estimate of the impact of applying the small business exemption (SBE). To do so, we first adjusted potential uncollected taxes on a state-by-state basis to omit the surveyed firms in the Internet Retailer Top 500 from the state-by-state calculation, and then calculated potential uncollected taxes for the

[42] That is, for the 50 firms we surveyed in the middle 300, we calculated for each state the proportion of those firms' sales upon which they collected taxes, and then applied that percentage to the estimated state-by-state sales of all 300 firms.

"tail" by allocating to the states only those potential revenues that would not be affected by the SBE.

Finally, we calculated estimated uncollected revenues for 2012 by applying our national projected growth rate for uncollected revenues to the 2008 estimate for each state.

Our estimates, as well as the 2008 and 2012 baseline estimates from the *Fox Study*, are presented in Table A-1. As the data there indicate, our estimates are substantially below those of the *Fox Study* for every state other than Alaska; and, for some key states, they are dramatically lower. For example, the Fox Study's baseline estimate suggests that uncollected revenues in California could reach $1.9 billion by 2012, whereas our estimate of less than $390 million (assuming an SBE) is only one fifth as high. Similarly, the *Fox Study's* baseline estimate indicates state and local governments in New York State could lose as much as $865 million, while our SBE-adjusted results show the correct figure is approximately $105 million. To the extent state revenue collectors and fiscal authorities have viewed the repeal of *Quill* as a "silver bullet" that would make up for a significant portion of current budget shortfalls, the figures in Table A-1 clearly demonstrate otherwise.

**TABLE A-1:**
**STATE-BY-STATE ESTIMATES OF POTENTIAL UNCOLLECTED REVENUES**
**($MILLIONS, 2008, 2012)**

| | 2008 | | | 2012 | | |
|---|---|---|---|---|---|---|
| State | Fox (baseline) | Eisenach-Litan | Eisenach-Litan with SBE | Fox (baseline) | Eisenach-Litan | Eisenach-Litan with SBE |
| Alabama | $115.5 | $75.3 | $46.8 | $170.4 | $92.8 | $57.8 |
| Alaska | $1.0 | $3.6 | $2.0 | $1.5 | $4.4 | $2.4 |
| Arizona | $250.8 | $79.3 | $49.5 | $369.8 | $97.8 | $61.1 |
| Arkansas | $77.2 | $49.6 | $30.6 | $113.9 | $61.2 | $37.7 |
| California | $1,291.6 | $503.9 | $316.1 | $1,904.5 | $621.4 | $389.8 |
| Colorado | $117.1 | $67.8 | $42.4 | $172.7 | $83.6 | $52.2 |
| Connecticut | $43.2 | $48.2 | $30.1 | $63.8 | $59.4 | $37.1 |
| DC | $24.1 | $3.5 | $2.2 | $35.5 | $4.4 | $2.7 |
| Florida | $545.1 | $227.7 | $142.9 | $803.8 | $280.8 | $176.2 |
| Georgia | $278.2 | $117.2 | $73.5 | $410.3 | $144.5 | $90.6 |
| Hawaii | $40.7 | $16.2 | $9.6 | $60.0 | $19.9 | $11.8 |
| Idaho | $31.4 | $17.8 | $11.1 | $46.4 | $21.9 | $13.7 |
| Illinois | $343.7 | $196.1 | $123.0 | $506.8 | $241.8 | $151.7 |
| Indiana | $132.5 | $95.9 | $59.9 | $195.3 | $118.2 | $73.8 |
| Iowa | $60.1 | $48.7 | $30.1 | $88.7 | $60.1 | $37.1 |
| Kansas | $96.9 | $29.5 | $18.4 | $142.9 | $36.3 | $22.6 |
| Kentucky | $74.6 | $36.0 | $22.4 | $109.9 | $44.4 | $27.6 |
| Louisiana | $268.5 | $95.9 | $60.1 | $395.9 | $118.2 | $74.1 |
| Maine | $21.7 | $18.3 | $11.2 | $32.1 | $22.6 | $13.8 |
| Maryland | $124.9 | $69.4 | $43.5 | $184.1 | $85.6 | $53.6 |
| Mass. | $89.0 | $87.9 | $55.1 | $131.3 | $108.4 | $68.0 |
| Michigan | $96.0 | $134.0 | $83.9 | $141.5 | $165.2 | $103.4 |
| Minnesota | $159.6 | $86.2 | $54.0 | $235.3 | $106.2 | $66.5 |
| Miss. | $91.5 | $40.6 | $24.9 | $134.9 | $50.1 | $30.8 |
| Missouri | $142.9 | $87.6 | $54.7 | $210.7 | $108.0 | $67.4 |
| Nebraska | $41.6 | $28.5 | $17.5 | $61.3 | $35.1 | $21.6 |
| Nevada | $114.6 | $40.6 | $25.4 | $168.9 | $50.0 | $31.3 |
| New Jersey | $137.3 | $123.0 | $77.0 | $202.5 | $151.7 | $94.9 |
| New Mexico | $81.7 | $26.4 | $16.5 | $120.5 | $32.6 | $20.3 |
| New York | $586.9 | $135.3 | $84.8 | $865.5 | $166.8 | $104.6 |
| N. Carolina | $145.0 | $112.4 | $70.2 | $213.8 | $138.6 | $86.6 |
| N. Dakota | $10.4 | $9.0 | $5.5 | $15.3 | $11.1 | $6.7 |
| Ohio | $208.8 | $156.1 | $97.7 | $307.9 | $192.5 | $120.4 |
| Oklahoma | $95.5 | $60.4 | $37.4 | $140.8 | $74.5 | $46.1 |
| Pennsylvania | $234.6 | $157.0 | $98.5 | $345.9 | $193.6 | $121.4 |
| Rhode Island | $19.7 | $16.8 | $10.5 | $29.0 | $20.7 | $12.9 |
| S. Carolina | $84.5 | $63.6 | $39.7 | $124.5 | $78.4 | $49.0 |
| S. Dakota | $20.2 | $13.2 | $8.1 | $29.8 | $16.2 | $10.0 |
| Tennessee | $278.6 | $105.1 | $65.7 | $410.8 | $129.6 | $81.0 |
| Texas | $590.3 | $319.6 | $200.4 | $870.4 | $394.1 | $247.2 |
| Utah | $60.0 | $35.3 | $21.8 | $88.5 | $43.5 | $26.8 |
| Vermont | $17.0 | $11.3 | $6.8 | $25.1 | $13.9 | $8.3 |
| Virginia | $140.4 | $71.9 | $45.1 | $207.0 | $88.7 | $55.6 |
| Washington | $191.2 | $78.3 | $49.1 | $281.9 | $96.5 | $60.6 |
| W. Virginia | $34.3 | $24.2 | $14.8 | $50.6 | $29.9 | $18.3 |
| Wisconsin | $96.4 | $66.9 | $41.9 | $142.1 | $82.5 | $51.7 |
| Wyoming | $19.4 | $7.9 | $4.8 | $28.6 | $9.8 | $5.9 |

August 16, 2011

The Honorable John Boehner
Speaker, U.S. House of Representatives
Washington, DC 20515

The Honorable Nancy Pelosi
House Democratic Leader
Washington, DC 20515

The Honorable Harry Reid
Senate Majority Leader
Washington, DC 20510

The Honorable Mitch McConnell
Senate Republican Leader
Washington, DC 20510

Dear Congressional Leaders:

The undersigned organizations write to express our strong opposition to S. 1452 / HR 2701, the Main Street Fairness Act, which would impose significant cost burdens on Internet-enabled businesses across the nation.

If enacted, this bill would overturn the Supreme Court's decision in the *Quill* case and allow a group of states to impose new and onerous tax collection burdens on Internet-enabled retailers and entrepreneurs, as well as other remote sellers that do not even reside in their state. The bill would cede Congressional power over interstate commerce to the Streamlined Sales Tax Governing Board, a body created by a few states that has shown it will further complicate the tax structure and increase the tax collection burden on Internet retailers. The Governing Board has not reduced the more than 7,500 taxing jurisdictions Internet retailers face, and even where this Governing Board has introduced simplification, it has granted exceptions as an inducement for states to join. Therefore, not only will this give a group of state governments far-reaching tax collection authority, but it will also undoubtedly impede the growth and development of interstate commerce, especially for small businesses.

Over the past decade, Internet-enabled businesses and entrepreneurs have become an integral part of our nation's economy and have produced hundreds of thousands of jobs. There is no doubt the Internet has been an engine for innovation, empowerment and economic development, especially in the world of retail. The Internet connects entrepreneurs across America, including individuals and in rural and disadvantaged communities, with consumers in every corner of the world. This "global market" provides businesses opportunities to grow and expand and enables consumers to access quality goods and services.

At a time when our nation is recovering from challenging economic times, we believe Congress should enact pro-growth policies that encourage and increase economic activity, not increase costs and burdens on our nation's businesses. The underlying premise of the

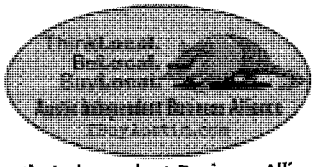
bill is that the sales tax simplifications proposed in the bill, as implemented by the Streamlined Sales and Use Tax Agreement, would make it simple for remote sellers to collect and remit sales tax for the member states. However, the simplifications proposed in the bill do not go far enough and do not represent the radical simplification needed that justify imposing a collection and remittance responsibility on remote sellers. The new burdens that S. 1452 and HR 2701 would force on our nation's online retailers and entrepreneurs will not only adversely impact hundreds of thousands of jobs, but would effectively put an end to the robust e-commerce market that consumers across the world currently enjoy.

We respectfully urge that you not consider this legislation, or any other legislation altering the tax collection rules on the Internet that places unfair burdens on Internet-enabled businesses and entrepreneurs.

We appreciate your consideration.

Sincerely,

Computer & Communications Industry Association
Colorado Technology Association
Direct Marketing Association, Inc.
Electronic Retailing Association
Illinois Technology Association
Information Technology Industry Council
NetChoice
NetCoalition
New Jersey Technology Council
North Carolina Technology Association
Northern Virginia Technology Council
San Diego Software Industries Council
Software Finance & Tax Executives Council
Software & Information Industry Association
Software and Information Technology Association of Kansas
TechAmerica
Tech Council of Maryland
TechNet
TechPoint (Indiana)
TechQuest Pennsylvania
Utah Technology Council
Washington Technology Industry Association



Austin Independent Business Alliance
P.O. Box 49545 • Austin, Texas 78765
512-441-2123
www.IBuyAustin.com

November 4, 2011

The Honorable Lamar Smith
U.S. House of Representatives
Committee on the Judiciary
517 Cannon HOB
Washington, DC 20515

RE: Fair Sales Tax Collection

Dear Congressman Smith,

I am writing to you as the President of the Austin Independent Business Alliance, and association of approximately 400 Austin businesses.

We have been following the progress of the response to this critical issue both in Texas where State Representative John Otto filed a bill that was passed overwhelmingly in the last legislature and in Congress where several bills have been filed and more are on the way.

The Austin Independent Business Alliance is unanimously in favor of a federal solution to this problem. We ask you to support the legislation whether it be HR 3179 or a variation of it so long as its purpose is to level the playing field and allow us to compete fairly in the marketplace. This bill means jobs for Texans and sales tax revenue that is already due but not being collected for Texas. It would support the members of my local group, but it would also support our peers across Texas and the country.

Please support Texas business. Please support legislation to give us a chance to compete without one hand tied behind our backs.

Thank you,

Steven Bercu
President, AIBA




November 29, 2011
**For More Information:**
James Bologna, 202-974-6456, jbologna@hudson.org

## Hudson Report Predicts Up to $330 Billion at Stake in Sales Tax Battle

WASHINGTON—More Americans are turning to the Internet to shop this holiday season, buoyed in part by the lure of what they believe to be tax-free shopping. Because of a loophole in federal law that pre-dates the Internet, the traditional "brick and mortar" store is under economic siege by a variety of out-of-state sellers who are not required to collect state sales taxes.

A new report from Hudson Institute, entitled *Future Marketplace: Free and Fair*, finds that the sales tax loophole is equivalent to a subsidy, distorting the free market by providing an incentive for one form of economic activity over another.

The report, authored by Hudson Visiting Fellow **Hanns Kuttner**, says up to $330 billion in annual sales will be subject to government special treatment for online, out-of-state sellers in 2012.

"As more people shop online, local businesses that are put at a competitive disadvantage by the government will lose," says Kuttner.

Click ***here*** to download a one page summary of the report.

Click ***here*** to download the full report.

Hanns Kuttner is available for comment: hkuttner@hudson.org.

# # #

Hudson Institute is a nonpartisan policy research organization dedicated to innovative research and analysis. Founded in 1961, Hudson is celebrating a half century of forging ideas that promote security, prosperity, and freedom. http://www.hudson.org




# *Future Marketplace: Free and Fair*

## Report Highlights

*Free markets offer the lowest price on the most efficient basis.*

- Government actions that "distort" a free market include taxes, subsidies, and regulations.
- Current federal policy creates special treatment for out-of-state sellers in the 45 states, home to 97 percent of Americans, with general sales taxes.

*Federal policy will put the location of up to $330 billion sales in play in 2012.*

- This number reflects estimates of estimates from the National Conference of State Legislatures about the impact of out-of-state sales and an average state and local sales tax rate of 7.05%.
- Out-of-state sellers benefit from a federal policy loophole that keeps states from requiring out-of-state sellers to collect the sales tax.
- The techniques of out-of-state selling have expanded from catalogs to include electronic data interchange and Internet web sites.

*The price difference from the tax loophole distorts the market, just as other taxes, subsidies, and regulation do.*

- A market in which some sellers must collect sales tax and other, out-of-state sellers do not, distorts which sellers have the lowest price.
- Compared to an unsubsidized market, more sales go to out-of-state sellers.

*Changes in information technology (IT) are will make the future marketplace different from that of today.*

- The Internet is bringing more sellers within reach of buyers.
- Goods which have standard characteristics and low weight are most likely to see increases in sales by out-of-state sellers.
- Software, both off-the-shelf and customized, has made it easier for sellers to figure the sales tax owed in all states.

50*th* Anniversary
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ECONOMIC POLICY / BRIEFING PAPER



# Hudson Institute

## *Future Marketplace: Free and Fair*

By Hanns Kuttner

November 29, 2011

Hudson Institute
1015 15*th* Street, NW
Sixth Floor
Washington, DC 20005
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PREPUBLICATION VERSION
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11/29/2011

# *Future Marketplace: Free and Fair*

A free market provides buyers with the best terms and lowest prices. When that price reflects the actions of third parties, like government, the result is a distortion away from the efficient, free market price. Government actions that distort a free market include taxes, subsidies, and regulations that prefer one form of economic activity over another.

Current federal policy treats different sellers differently. States may set a sales tax but federal policy then creates a loophole for out-of-state sellers. The general sales tax used in 45 states, home to 97 percent of the American people, interacts with state lines and federal policies to create a preference for buying from out-of-state. This distortion between the share of sales that go to in-state versus out-of-state sellers will effect the sale of up to $330 billion worth of goods and services in 2012.

This distortion reflects the price difference between purchases from in-state and out-of-state sellers. Federal policy allows states to compel in-state businesses to collect the sales tax owed by the final consumer. It does not allow them to impose the same requirement on out-of-state sellers who sell by catalog, toll-free numbers, electronic data exchange, and, to a growing extent, over the Internet, unless the seller has a physical presence in the state. These out-of-state sales can become "no state" sales, with the sales tax of no state collected on them. This special treatment gives "no state" sellers a price advantage, an advantage they can use to gain a larger market share than they would have in a market without government distortion.

In a free market, buyers get the lowest price. That lowest price can be the truly lowest price or it can be the result of government distortion that favors one group of sellers. A market in which one seller collects the sales tax and another does not distorts the location of sales. Compared to the division that would prevail in a free market, out-of-state sellers get a larger share in a market where state governments must give a preference to out-of-state sellers.

The subsidies and distortions that result from the loophole currently required by the federal government are longstanding. Changes in the technology of buying and selling are increasing the size of the distortion. Information technology is narrowing the distance between buyers and sellers even though the physical distances remain the same. As a result, the size of the subsidy and resulting distortion will grow over time.

This report explains how this distortion and its subsidy for out-of-state sellers has come to be and how the federal government keeps the loophole from being closed. It also reviews policy options for addressing it. These range from abandoning the general sales tax as unworkable in the 21st century to keeping it and using technology to simplify the complexity of complying with the sales tax laws of multiple states.

Subsidies as a source of distortion in a free market

In a free market, buyers and sellers come together and agree on a price. What it means to come together is changing. Over time, a smaller share of market transactions involve face-to-face interaction. A succession of new technologies has created alternatives to face-to-face dealings; Benjamin Franklin is credited with introducing the first mail-order catalog. Where the alternatives serve buyers better than face-to-face, buyers have embraced them. The alternatives have come to include catalogs, toll-free calls to call centers, and a variety of information technologies that can be gathered under the heading of "e-commerce." Altogether these alternatives are the different forms of "remote selling"

Many sales can take place through either face-to-face or through one of the forms of remote sales. Competition in many markets shows some of the market goes to sellers who interact with buyers face-to-face and some to sellers who sell remotely. The equilibrium between physical presence and remote sales in the market for each good or service reflects many factors. Some relate to the nature of the good or service being sold. Others relate to purchaser preferences. Together these forces determine the free market division between face-to-face an remote sales.

However, if there is a distortion in the marketplace, whether from subsidies, taxes, or regulation, there will be a different division between face-to-face and remote. This difference is a loss of efficiency relative to a free market.

Distortions from government action can have an impact on the share that is face-to-face compared to remote. Current policy makes the sales tax a distortion. Current policy gives remote sellers a price advantage, allowing them to sell their goods and services without collecting the sales tax owed by the purchaser. This price difference functions like a subsidy. It distorts the allocation between the two forms of selling. The subsidy from not collecting tax due means a larger share of sales will take place remotely than would occur in a free, undistorted market.

The difference in the face-to-face/remote split under a free market and a market with distorting subsidies varies according to the nature of the good or service. Four factors that influence the efficient allocation between face-to-face and remote sales are:

- **Standardization.** Products that have standard descriptions or characteristics make

it less important for the purchaser to assess goods in person before buying. Standardization increases the potential share of purchases made without face-to-face interaction. The availability of standards for many industrial commodities (grades of steel, standards for purity of chemicals) helps explain why "business to business" sales dominate the dollar volume of e-commerce.

Individual consumers also buy standardized products. Make and model numbers allow consumers to make sure the product offered by two sellers is the same. A consumer can gather information from a variety of sources: walk into store, look at the websites of online sellers. From this a consumer can decide which product is best. The information contained in a few pieces of information -- brand, make, model number -- is enough to allow comparing price across and between physical and online sellers, confident that the product is the same.

- **Product comparability**. A restaurant that buys a five gallon container of cooking oil obtains a comparable product whether the container comes across state lines or from a local vendor. With services, immediacy is often an important component. Further advances in logistics would be required for remote sellers to erode the strong advantage of physical sellers. Again, restaurants offer an example. A remote seller offering a meal that will be delivered tomorrow and which must be warmed upon arrival is a weak competitor to a restaurant that offers a meal served within the hour.

**Cost of transportation**. The additional cost of sending some goods hundreds of miles can be a small share of the final sale price for some goods and a large share for others. This effect can undo the price advantage of a remote seller who does not collect the sales tax. Transportation costs represent a large share of the cost of stone and other building aggregates delivered to a construction site. Rock aggregates are an example of a category where the price difference from the sales tax does little for remote sellers. Software represents the opposite case. Software can be downloaded via the Internet. The transportation cost does not vary with the distance the product travels.

- **Consumer preference**. The conditions of a competitive market often leave little room for factors other than price and objective characteristics to influence business-to-business sales. That does not hold for sales to consumers. Each consumer has a different attitude towards the shopping experience. Some enjoy giving close personal examination before buying. Others do not enjoy shopping and would be willing to pay more for the privilege of not going to a store to buy. Even at the level of the individual consumer these attitudes can vary from product category to category.

The size of the distortion, measured as the difference between the share that occurs in a subsidized and a free market, depends on how sensitive sales are to the price difference the subsidy creates. Where price is the first, last and only criterion in the

purchaser's decision making process, the gap is larger. Goods and services with a high degree of standardization, comparability between local and remote sale, and low cost of transportation are most likely to have a larger gap between the efficient and the subsidized division between face-to-face and remote sales. Table 1 shows categories where there is a low, medium, and high potential for distortion because of the subsidy.

Table 1. **Potential for Remote Sales**

| Low | Medium | High |
|---|---|---|
| Convenience purchases | Appliances | Books |
| Gasoline | Furniture | Clothing |
| Motor vehicles | Insurance | Consumer electronics |
| Personal services | | Music recordings |
| Restaurant meals | | |

The four factors that influence the share of sales that are face-to-face versus remote make it not surprising that "business to business" ("B2B") sales dominate e-commerce. At this point in the evolution of the marketplace, remote selling has obtained a far greater share of the B2B market than sales by businesses to consumers ("B2C"). The Census Bureau estimated that third quarter retail "e-commerce" sales were 4.6 percent of all retail sales.[1] While about triple the level of about a decade ago, it is still far below the level that it could reach as both the technologies that allow access to e-commerce and define the Internet buying experience increase capabilities.

How much subsidy is there?

The subsidy is the sum of the price advantage that out-of-state sellers get from being able to offer prices that do not include the sales tax in the customer's state. Using the most recent estimates from the National Council of State Legislatures (NCSL), the total amount of sales with sales tax not collected will be $330 billion in 2012. The average state and local sales tax rate in the sales tax states is 7.05 percent under tax rates of late in 2011. Applying the sales taxes which are imposed in the states where those customers are produces a sales tax amount of $23.3 billion. Table 2 shows the amount of sales and sales tax involved in each of the states which imposes a sales tax.

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[1] US Census Bureau, "Quarterly Retail E-Commerce Sales 3rd Quarter 2011," CB11-186, November 17, 2011 http://www.census.gov/retail/mrts/www/data/pdf/ec_current.pdf. The Census Bureau defines retail sales by the nature of the seller, not who buys, thus this definition includes both business-to-consumer sales as well as some business-to-business sales. E-commerce is one part of remote sales by out-of-state sellers which also includes catalog sales and calls to toll-free numbers spurred by radio and television advertising and direct mail. The Census Bureau data also does not break down e-commerce sales between in-state sellers who are already required to collect the sales tax and out-of-state sellers who are not.

**Table 2. Sales at Stake**

| | Sales Tax Due ($, millions) | Average Sales Tax Rate (%) | Total Untaxed Out-of-State Sales ($, billions) |
|---|---|---|---|
| Alabama | 347.7 | 8.25 | 4.21 |
| Alaska | 3.0 | 1.40 | 0.22 |
| Arizona | 708.6 | 8.15 | 8.69 |
| Arkansas | 236.3 | 8.25 | 2.86 |
| California | 4159.7 | 8.20 | 50.73 |
| Colorado | 352.6 | 6.40 | 5.51 |
| Connecticut | 152.4 | 6.35 | 2.40 |
| District of Columbia | 72.5 | 6.00 | 1.21 |
| Florida | 1483.7 | 6.65 | 22.31 |
| Georgia | 837.6 | 6.95 | 12.05 |
| Hawaii | 122.5 | 4.35 | 2.82 |
| Idaho | 103.1 | 6.05 | 1.70 |
| Illinois | 1058.8 | 7.90 | 13.40 |
| Indiana | 398.8 | 7.00 | 5.70 |
| Iowa | 181.0 | 6.85 | 2.64 |
| Kansas | 279.2 | 6.00 | 4.65 |
| Kentucky | 224.5 | 8.75 | 2.57 |
| Louisiana | 808.3 | 5.00 | 16.17 |
| Maine | 65.4 | 6.00 | 1.09 |
| Maryland | 375.9 | 6.25 | 6.02 |
| Massachusetts | 268.0 | 6.00 | 4.47 |
| Michigan | 289.0 | 7.20 | 4.01 |
| Minnesota | 455.2 | 7.00 | 6.50 |
| Mississippi | 303.3 | 7.25 | 4.18 |
| Missouri | 430.2 | 6.00 | 7.17 |
| Nebraska | 118.1 | 7.85 | 1.50 |
| Nevada | 344.9 | 6.95 | 4.96 |
| New Jersey | 413.4 | 6.55 | 6.31 |
| New Mexico | 246.0 | 8.45 | 2.91 |
| New York | 1767.0 | 6.85 | 25.80 |
| North Carolina | 436.5 | 5.85 | 7.46 |
| North Dakota | 31.3 | 6.80 | 0.46 |
| Ohio | 628.6 | 8.20 | 7.67 |
| Oklahoma | 296.3 | 6.40 | 4.63 |

| | | | |
|---|---|---|---|
| Pennsylvania | 706.2 | 5.50 | 12.84 |
| Rhode Island | 70.4 | 7.00 | 1.01 |
| South Carolina | 254.3 | 7.15 | 3.56 |
| South Dakota | 60.8 | 5.50 | 1.11 |
| Tennessee | 748.5 | 9.45 | 7.92 |
| Texas | 1777.1 | 8.00 | 22.21 |
| Utah | 180.7 | 6.70 | 2.70 |
| Vermont | 44.8 | 6.05 | 0.74 |
| Virginia | 422.7 | 5.00 | 8.45 |
| Washington | 541.0 | 8.80 | 6.15 |
| West Virginia | 103.3 | 6.00 | 1.72 |
| Wisconsin | 289.0 | 5.45 | 5.30 |
| Wyoming | 61.7 | 5.40 | 1.14 |
| Total | 23260.0 | | 329.84 |

Sources:
Sales tax due: National Conference of State Legislatures
Sales tax rates: The Sales Tax Clearinghouse (rate is sum of state and average local (city and county) rates)

The $330 billion in sales is a measure of the distortion from the current loophole that keeps states from collecting tax on sales to their residents that come in from out-of-state. It shows the maximum amount of sales that could change sales mode if the loophole closed. The extent to which sales would change from remote to local if states collected tax on the remote sale depends on how much sales respond to changes in price.

Changing technology and changes in the efficient division between in person and remote sales

The level of sales that benefits from the favorable treatment enjoyed by out-of-state sellers reflects both old technology and more recent shifts.

Remote selling is not new. Montgomery Ward and Sears, Roebuck and Co. pioneered mass catalog selling in the 19th century, long before any state imposed a general sales tax.

Each successive innovation in technology brought new opportunities for remote selling. Toll-free numbers advertised on radio and television created new opportunities for sellers to find customers across state lines. A steady decline in the real price of computing power has enabled catalog sellers to buy and exchange lists, mining data to

target their mailing to customers who are most likely to buy.

Electronic interchange has made tremendous inroads in how businesses come together to buy and sell. The purchasing agent working with a stack of product catalogs on his or her desk has given way to a purchasing agent going to a web site, perusing the electronic version of the paper catalog and placing an order. In other cases, where volumes are larger and processes more integrated, the purchasing agent has been replaced by software. One company's production planning system electronically interacts with the supplier's software to place an order. In the case of multiple vendors, the production planning system may electronically request bids, receive those bids, and apply algorithms the purchaser has developed to decide which bid to accept.

In the market for some products a very large share of transactions has already become "e-commerce." While the average consumer is more familiar with remote selling and e-commerce in the form of catalogs and merchant web sites, the dollar amounts are much greater in proprietary electronic data exchange relationships between businesses.

The consumer market (referred to as "business to consumer" or "B2C") lags the "business to business" (or "B2B") market. While it has lagged, the B2C side also has many more possibilities for future growth.

Even as growth proceeds more rapidly on the B2C side, some possibilities appear unlikely. Standardization, comparability and transportation costs mean many possibilities have intrinsic limitations that will never be overcome. Many services, whether restaurant meals or a massage, are in this category. The small quantities in which consumers buy many products give an advantage to physical sellers who realize scale economies by taking shipments in a case. Buying a pack of gum will remain the natural province of physical sellers.

However, advances in technology are rapidly changing the efficient allocation between physical and remote sales. Changes in telecommunications technology are rapidly shifting the equilibrium point between physical and remote sales. The speed at which consumers access the Internet has gone up. The term "Cyber Monday," referring to a rush of Internet sales when consumers returned to work on Monday after Thanksgiving, had its origins in a time when workplaces typically had much faster Internet connections than homes. Broadband's growing availability has made the average at-home Internet upload and download speed much higher.

Other changes in telecommunications technologies are increasing the opportunities for consumers to buy remotely. The omnipresence of access to the Internet is giving a new meaning to "24/7." At the time of the Internet boom in the late 1990's, buying something over the Internet meant sitting down at a desktop computer with an Internet connection. The emergence of smartphones and tablet computing has put individuals within reach of the Internet for more of their waking hours. The thought

of buying something over the Internet need not be deferred until arriving at home or the office and having the time to sit down and place an order.

Other changes are blurring the line between physical presence and remote sale. Cell phone apps offer the potential for a consumer to visit a store, identify the product he or she wants to buy, but decide he or she wants to have a different color. The in-store merchandising could show the range of colors available. The consumer could decide to buy a color not on display and use a cell phone app to order the preferred color to be shipped to his or her house.

Subsidies administered through the sales tax system

Among the consequences of the Great Depression was a crisis in public finance. State governments were both financially pressed and subject to requirements in state constitutions that they balance their budget. From this combination emerged the sales tax. In 1933 alone, twelve states made the decision to impose a general sales tax.

States had long imposed taxes on particular articles (for example, alcoholic beverages.) In contrast to taxes on particular items, the new sales taxes were general taxes, imposed on all sales to final consumers. By 1950, 30 states had general sales taxes; by 1969, the number was 45, where it remains to this day. Alaska has no statewide tax, but some local governments impose a sales tax. Even in states without a general sales tax, there are particular sales taxes. New Hampshire, for example, has a 9 percent rooms and meals tax that functions like a sales tax but is applied only to hotel rooms and restaurant meals that cost 36 cents or more.

States that adopted the sales tax also adopted another tax called the use tax. The combined sales and use tax allowed states to treat purchases equally, whether made from an in- or out-of-state seller. The sales tax applied to purchases of goods within the states. Naturally, states did not want to create incentives for their citizens to make out-of-state purchases to avoid the sales tax. The concept of a use tax addressed those incentives. While sellers would collect the sales tax, the use tax was collected by the purchaser who faced the burden of self-assessing the tax obligation and remitting it to the state.

Both the sales and use tax apply to final purchasers. Both businesses and consumers can be final purchasers. Only a portion of purchases by businesses are final purchases. Wholesalers do not pay sales tax on goods they buy from manufacturers to sell to retailers. Wholesalers do pay sales tax on the warehouse trucks and office furniture they buy if those items are subject to the state's sales tax.

The size of subsidy depends on the degree of compliance with the sales tax law. If there are two sellers, one who collects the sales tax and one who does not, the uncollected sales tax is a subsidy that could wind up being split to a varying degree

between the buyer and seller. The amount of sales tax creates a wedge between the seller who collects the tax and the seller who does not. What happens to the wedge depends on the relative bargaining power of buyer and seller. At one extreme, the buyer loses the entire wedge to the seller and the seller pockets all of the subsidy. At the other, the seller bargains away the price difference and the subsidy goes to the buyer. Repeated interactions, as between two businesses that have a customer-supplier relationship, offer an opportunity for buyers to get more of the wedge. In "take it or leave it" interactions that individual consumers have with sellers, sellers are much better positioned to hold on to the price difference.

There can be less than perfect compliance with state revenue laws for both in-state and out-of-state purchases. Enforcement studies show that there generally is a high degree of compliance with the sales tax, especially when the buyer, the seller, or both is a large and sophisticated corporation which has a staff that has as its primary task making sure the company complies with the tax laws. Lower levels of compliance occur among less complex businesses. Some failure to comply may be driven by complexity in the sales tax laws. Both types of sales and categories of purchases can be exempt. An examination of the frequency with which a state's sales tax collection agency gets mention in bankruptcy petitions filed by small businesses shows not remitting the sales tax collected can be a form of "desperation finance."

With out-of-state purchases, where the applicable tax is the use side of the sales and use tax, compliance is much lower. One reason for the lower compliance is obvious: the seller is under no legal obligation to collect the tax, leaving the tax to the purchaser. Large and sophisticated organizations, again, may understand their obligation to pay the tax, but even they suffer from the asymmetry of being in the position of a buyer versus that of a seller. As sellers, firms specialize. They have reason to be familiar with the nuances of definitions of what is and what is not in the sales tax base. As buyers, they are more likely to be buying a more disparate bundle, buying both the primary inputs for their product as well as a broad variety of goods and services that allow the firm to do all the things that are ancillary to their primary business. They buy cleaning supplies, replacement parts for their vehicle fleet, computers and software, paper for use in the computer printers.

Individual consumers face the same set of challenges as businesses without the benefit of a tax department to help them figure out the details of use tax compliance. The low degree of compliance with the use tax begins with low levels of awareness that there even is a use tax. It is fed by the burden of compliance. One part of the burden is recordkeeping. Another is applying the correct tax concept to each receipt gathered in the recordkeeping process. For example, a consumer in Rhode Island, which imposes a 7 percent sales tax, who purchases an appliance in Massachusetts, where the sales tax is 5 percent, is obligated to pay the two percent difference as a use tax to Rhode Island.

Why is there an out-of-state sales tax loophole?

When the first states responded to the desperate financial circumstances of the Great Depression by adopting a general sales tax, they recognized that a sales tax on purchases in the state collected by sellers in the state would not reach purchases that their residents made out-of-state.

Their response to out-of-state sales was intellectually cohesive but a practical failure. This response was the use tax. For purchases in the state, the state could designate or create a revenue collection agency that would work with businesses in the state to collect the tax and remit it to the state. Trying to collect from businesses outside the state presented both legal and practical problems. From a legal perspective, it was unclear how a state could position itself to collect in other states. From a practical perspective, a state would be looking at a trying to create relationships with a vast number of businesses, many of which would have no or few sales to the state. It would not be cost-effective to pursue many of the out-of-state sellers.

Thus states adopted a different strategy to collect and remit the tax due on sales to their residents from out-of-state. States created a parallel tax to the sales tax called the use tax. Instead of the seller, the use tax would rely on self-reporting by purchasers.

As noted above, self-reporting by businesses does happen. About 10 percent of the revenue collected by state and local government as sales and use tax is use tax. Almost all of it is payments made by businesses. However, estimates of the size of the out-of-state sales loophole suggests that compliance is far from perfect.

The practical challenges of enforcing the use tax from individuals show that it falls afoul of Colbert's (17th century French tax minister, not 21st century television figure) maxim that the challenge of taxation is to collect the maximum number of feathers with a minimum of hiss. To comply with the use tax, a taxpayer faces the burden both of recordkeeping and applying a complex body of law.

Recordkeeping would require a separate shoe box for receipts from out-of-state purchases. Processing those receipts would begin by identifying whether the sales tax has already been collected. Some sellers already participate in the Streamlined Sales Tax process. Those out-of-state sellers who have a physical presence in the buyer's state already collect the sales tax, meaning no use tax is owed. The next step would be to separate which purchases are subject to tax and which are not, a task that requires both knowing the general categories of purchases exempt from tax (in many states, groceries) and the state's revenue rulings over the years that have spoken to whether a particular good or service qualifies under the exemption. For example, is chocolate ordered from out-of-state a grocery not subject to the sales tax?

One approach that has been taken by some of the states is to look for use tax compliance in the income tax return. Twenty three states that impose both a sales and

income tax try to collect the use tax on the income tax return. Eleven states include something on the income tax return that has to be completed about potential use tax liability. Nine states provide a table which taxpayers can use to find an estimated use tax liability appropriate to the taxpayer's income.

Despite these measures, only 1.6 percent of taxpayers report use tax in the eleven states that make an effort to collect use tax as part of the income tax return. The state with the highest share of returns showing use tax liability is Maine, where 11.3 percent of taxpayers reported use tax obligation on their 2007 tax returns. That may reflect the presumption that Maine had made that use tax liability was 4 percent of income if the taxpayer did not report some other amount, a practice which ended in 1999. [2]

Why don't states fix the loophole?

The impracticality of the use tax had fewer consequences when states first adopted sales and use taxes. At that time the largest distortion might have been along state borders. Buyers could order goods from sellers across the state line to be delivered or sent by mail. If the seller had no physical presence on the buyer's side of the border, the seller would be unlikely to collect the tax owed by the buyer. The prototypical problem might have been Virginians going into North Carolina to buy furniture. The Virginia address on the invoice would show a North Carolina state tax auditor that no tax was required. Absent voluntary self-reporting by the Virginian who purchased the furniture, Virginia revenue authorities would never know about the purchase and use tax obligation.

As selling technology changed, states made efforts to keep the administration of their tax laws up to speed with those changes. The courts responded to these state initiatives by clarifying what key concepts in the US Constitution implied for administering a sales tax. (See NOTE: "The Supreme Court and Limits to State Power to Tax" at end of report.)

Catalog sales raised a range of issues. A decade after states began to impose general sales taxes, the Supreme Court decided that sellers who both had stores and catalogs could be required to collect sales tax on catalog sales, even when the merchandise was shipped from out-of-state and not the in-state store. The Court has hewed to the view that a seller must have a store or other physical facility in a state before the seller can be required to collect the state's sales tax, affirming its position in *National Bellas Hess* (1967) and *Quill* (1992), both cases that involved catalog sellers.

The Supreme Court decisions have been the work of one branch of the federal

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[2] Nina Manzi, "Use Tax Collection on Income Tax Returns in Other States." Policy Brief, Research Department, Minnesota House of Representatives, June 2010.

government to preserve federal prerogatives. The Court has noted that the legislative branch might also set policy on whether requiring out-of-state sellers to comply with state sales tax laws is an undue burden on interstate commerce. As the Court wrote in its *Quill* decision, "Congress is now free to decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes."

Since the 1992 decision, new possibilities have emerged. In addition to selling through stores and catalogs, sellers have an additional hybrid strategy, offering consumers a choice of buying at a physical store or online. These hybrid sellers have no choice but to collect the sales tax on their online sales.

When companies that sell remotely have acquired physical presence in more states, they lose their ability to ignore the sales tax in those states. Sears' purchase of Lands End offers an interesting example of what current federal policy implies. Before being bought by Sears, Lands End had a small physical footprint, focused on one state: Wisconsin. However, its new parent, Sears, had stores in every state. The result is Lands End now collects the sales tax on behalf of all states.

Circuit City Stores shows one more possibility: leaving selling through stores and selling only through the Internet. Following Circuit City Stores' bankruptcy and subsequent liquidation, an entrepreneur purchased the rights to the Circuit City name, allowing for the resurrection of Circuit City as an online-only seller. In its new form, Circuit City.com is liberated from the burden of collecting sales tax for states other than where it has a distribution center.

Future directions in the technology that brings together buyers and sellers

From the perspective of the 1990's, the possibilities of buying and selling that have become available would be surprising. Time of day and distance from seller have become irrelevant constraints. No doubt the world of twenty years hence will bring its own surprises in the technologies that bring together buyers and sellers.

Physical limitations will remain important in many categories. Sales at gasoline stations, which were just under 10 percent of all retail sales in 2009, offer an example of how physical limitations will limit change. Gasoline's weight relative to its sale price and the scale economies in transporting it by tanker truck make it unlikely to be something that would ever be sold remotely, at least in the volumes bought by the typical household. Remote sellers would find it difficult to match a characteristic consumers value about the non-gasoline items sold by gas stations: immediate availability.

Standard setting for products sold "business to business" long preceded the rise of information technology and the possibilities that opened for remote selling. There are many possibilities on the consumer side that technology has not yet reached but could.

Some possibilites:

- **Clothing.**

More standard setting and more parameters in standards. Men's shirts are available not just in Small-Medium-Large but also in two-parameter sizing: neck and sleeve length. Multiple parameters, combined with computer-controlled made-to-order processes, could tilt more of the clothing market towards remote purchases.

Technologies that combine pictures of individuals with particular clothing styles, fabrics, or colors could increase the sensory richness of the online shopping experience.

- **Sensor-driven purchasing.**

Refrigerators and home pantries can be equipped with sensors using RFID tags that track household inventories. Consumers could set inventory alerts that could also be set to access the Internet and automatically order more when supplies run low. While many grocery items are exempt from sales tax in many states, other kitchen items (e.g., plastic bags) are not.

Reducing the burden of compliance

When the Supreme Court last stated federal policy on sales tax compliance, in the 1992 *Quill* decision, advances in information technology have reduced the burden faced by sellers who must collect the sales tax of multiple states.

No matter whether a sale occurs face-to-face or remotely, the information technology supporting any transaction is more capable today than it was a generation ago. Compared to the real-time analytics applications used by the most sophisticated sellers, the software module required to determine if a sale is subject to sales tax and calculate the correct amount is trivial. A seller which does not have some information technology supporting the sales process is rare. Sellers can turn to either customized applications or off-the-shelf software that can calculate the sales tax for any jurisdiction in the country. They can also turn to third-parties to do compliance for them. For example, Amazon will collect sales taxes for all jurisdictions for those who use Amazon to sell as Amazon marketplace clients for a 2.7 percent fee.

Choices made by state and local governments add to the burden of complying with the sales tax. Rates can change at any time of the year. A city or county government can subject different items to tax or exempt certain items.

**Policy options**

1. *Reduce the scope of the general sales tax.*

The playing field could be leveled between in-state and out-of-state up or it could be

leveled down. State and local governments could look at the potential for remote selling and apply the general sales only to goods and services which are not likely to be sold remotely.

Some states accomplish this already on a time-limited basis through sales tax holidays. These holidays allow purchase of some goods with no sales tax for a certain period of time. "Back to school" time purchases of clothing are an example.

2. *Get rid of the use tax on purchases by individuals.*
Only a small share of people make an effort to comply with the use tax. Ending the tax on purchases by individuals would end the figment that there is a use tax. Taxpayers would be made more honest and state revenues only the tiniest bit smaller.

3. *Close the loophole.*
Congress could accept the invitation from the Supreme Court to articulate a standard for an undue burden on interstate commerce. The simplification framework developed by the states in the Streamlined Sales and Use Tax Agreement offers an example of a standard that Congress could endorse.

**NOTE:**

The Supreme Court and State Power to Tax

The sales tax has presented many questions over the years about the implications of the Commerce Clause of the Constitution (Article I, Section 8: "The Congress shall have Power ... To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes;")

In the years before states created general sales taxes, the Supreme Court saw the Commerce Clause imposing sharp restrictions on state taxes, holding in 1888 that "no State has the right to lay a tax on interstate commerce in any form." (*Leloup v. Port of Mobile* 127 US 640, 648).

This was the legal context against which states adopted general sales taxes beginning in the 1930's. They imposed a sales tax on intrastate commerce, with the in-state seller responsible for collecting the tax and a use tax on those who were within the state, bought from interstate commerce and used the good or service within the state.
An early question was the status of the two big retailers who both operated stores and sold by catalog, Sears Roebuck and Montgomery Ward. In a pair of cases decided in 1941, the Supreme Court held that a seller than maintained local retail stores meant the seller would have to collect sales tax on catalog sales in the state. (*Nelson v. Sears, Roebuck & Co.*, 312 U.S. 359; *Nelson v. Montgomery Ward & Co.*, 312 U.S. 373.)

Changes in the marketplace allowed the Supreme Court to consider changes in selling

National Retail Federation®
*The Voice of Retail Worldwide*

**Submission of the National Retail Federation**

**to the**

**House Committee on the Judiciary**

**Hearing on Constitutional Limitations on States' Authority to Collect Sales Taxes in E-Commerce**

**November 30, 2011**

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As the world's largest retail trade association and the voice of retail worldwide, NRF represents retailers of all types and sizes, including chain restaurants and industry partners, from the United States and more than 45 countries abroad. Retailers operate more than 3.6 million U.S. establishments that support one in four U.S. jobs – 42 million working Americans. Contributing $2.5 trillion to annual GDP, retail is a daily barometer for the nation's economy. NRF's Retail Means Jobs campaign emphasizes the economic importance of retail and encourages policymakers to support a Jobs, Innovation and Consumer Value Agenda aimed at boosting economic growth and job creation. www.nrf.com

**Summary of Comments**

Members of the National Retail Federation believe that Congress must resolve the 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, 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 collect sales taxes. This disadvantage is not created by the marketplace, but rather it is imposed by the current state of the law following the *Quill* decision, stifling retailers across the country.

In addition to the pricing disadvantage caused by sales tax being included in the cost of the purchase from the brick-and-mortar store, local stores also bear a significant compliance burden for collecting the tax. Compliance costs for small retailers are extremely high, placing them at more of a competitive disadvantage.[1] The national average annual state and local retail compliance cost in 2003 was 3 percent of sales tax collected for all retailers: 13.47 percent for small retailers, 5.20 percent for medium retailers, and 2.17 percent for large retailers.[2]

Brick-and-mortar retailers are major contributors to the health of local communities and should not be placed at a disadvantage compared to remote sellers that have no local presence. Brick-and-mortar sellers employ people in the community, pay state and local income taxes, as well as property taxes. They sponsor local causes like the Little League, soccer, and Booster Clubs.

Simplification is a key component for reform of the sales tax collection system for both brick-and-mortar sellers and remote sellers who voluntarily collect sales tax. Many members of the NRF voluntarily collect sales tax on remote sales into states where they do not have a physical presence. In many instances, the retailers that voluntarily collect sales tax do so only from states that have adopted the Streamlined Sales and Use Tax Agreement ("SSUTA") because of the Agreement's simplified collection requirements.

Granting states the authority to collect sales tax from remote sellers will add significant resources to state budgets to support essential local service including teachers, police officers,

[1] PricewaterhouseCoopers LLP, *Retail Sales Tax Compliance Costs: A National Estimate Volume One: Main Report*, April 2006. "Small retailers" is defined as annual retail sales between $150,000 and $1 million.
[2] *Id.*

firefighters and ambulance crews. Remote sales include e-commerce, mail order sales, telephone orders, and deliveries made across state lines. By 2012, total e-commerce sales are estimated to reach $4 trillion dollars.[3] Annual national state and local sales tax losses on e-commerce alone are conservatively expected to grow to $11.4 billion by 2012 for a six-year total loss of $52 billion.[4]

NRF is encouraged by this Committee's interest in this issue as well as the several legislative proposals that have been introduced this Congress to address sales tax fairness. NRF supports Congress granting states remote collection authority with simplifications that ensure retailers are not unduly burdened by collecting and remitting sales taxes.

**Background**

In 1992, the U.S. Supreme Court ruled in *Quill v. North Dakota* that "remote sellers" — a category that includes mail-order, telephone and Internet merchants — cannot be required to collect sales tax from customers in states where the merchant does not have a physical presence or "nexus." The court reasoned that the sales tax system was too complex for a merchant to know what sales tax to charge an out-of-state customer — 45 states and 7,600 local jurisdictions collect sales tax, each with its own rates, lists of taxable items and definitions of taxable items. But the justices suggested that sales tax collection could be required if the system were simplified and Congress authorized the collection authority because remote sellers are "purposely availing" themselves to a jurisdiction's authority by engaging in commerce.

In late 1999, in response to the Supreme Court ruling, states and the business community, including NRF, began the Streamlined Sales Tax Project, with an aim toward radical simplification of state sales tax systems. Since then, a baseline multi-state agreement, the SSUTA, which includes common definitions, uniform processes and procedures, and significantly simplified administrative features has been passed by 24 states (21 full member states and 3 associate member states), establishing the necessary groundwork for action by Congress. The 21 full member states with voting rights include: Arkansas, Iowa, Indiana, Georgia, Kansas, Kentucky, Michigan, Minnesota, Nebraska, Nevada, New Jersey, North Carolina, North Dakota, Oklahoma, Rhode Island, South Dakota, Vermont, Washington, West Virginia, Wisconsin and Wyoming. Three associate member states with negotiating authority but delayed voting rights are Ohio, Tennessee and Utah. Delegates from the 24 states administer the SSUTA through the Streamlined Sales Tax Governing Board.

In fiscal year 2012, it is conservatively estimated that state and local governments stand to lose at least $23.2 billion in uncollected sales and use taxes from remote transactions, with over $11.4 billion uncollected from e-commerce transactions.[5] As electronic commerce continues to grow, so will the losses to state and local revenues.[6] General sales taxes make up

[3] Donald Bruce, William F. Fox, and LeAnn Luna, *State and Local Government Sales Tax Revenue Losses from Electronic Commerce*, University of Tennessee, April 2009, available at http://cber.utk.edu/ecomm/ecom0409.pdf.
[4] *Id.*
[5] *Id.*
[6] *Id.*

roughly one third of state tax revenue.[7] Sales tax is primarily collected by the retail industry, and the retail industry continues to bear the compliance burden for this critical portion of state and local government budgets.[8]

Compliance Costs for Sales Tax Collection

A 2006 national study commissioned by a partnership of business and government organizations found the cost of compliance for retailers to collect sales taxes averaged more than three percent of the sales tax collected, a $6.8 billion annual cost to retailers at 2003 sales tax levels.[9] Nationally, the average sales tax compliance cost is more than six times greater for small retailers than for large retailers.[10] Brick-and-mortar retailers are bearing the burden of collecting sales tax in this unbalanced system.

The compliance burden on retailers is substantial, and it cannot be completely removed by new software or technology. Retailers identified ten categories of compliance costs in collecting and remitting sales tax:

1. Training of personnel on sales tax
2. Documenting tax-exempt sales
3. Customer service relating to sales tax issues
4. Sales tax-related software and license fees
5. Programming and servicing cash registers
6. Returns preparation and related costs (remittances, refund credits, and sales tax research)
7. Dealing the sales tax audits and appeals
8. Unrecovered sales tax paid due to bad debt
9. Debit/credit card interchange fees on sales tax collections
10. Other compliance costs.[11]

Complexity of sales tax rules between different jurisdictions are a leading cause of the cost burden for all retailers. For example, return preparation and related costs, documentation of tax-exempt sales and training of personnel on sales tax were the top three compliance issues for small retailers.[12] Large retailers identified debit/credit card interchange fees on sales tax collections, unrecovered sales tax paid due to bad debts, and training of personnel on sales tax as the most costly compliance issues.[13] The disparity in collection costs is significant between both small and large retailers and well as between brick-and-mortar retailers and remote retailers. Protecting the robust simplification steps already adopted by 24 states will go far in addressing this disparity and help bring competition back to Main Street.

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[7] Lucy Dadayan and Robert B. Ward, *State Revenue Report*, The Nelson A. Rockefeller Institute of Government, Oct. 2011, No. 85, available at http://www.rockinst.org/pdf/government_finance/state_revenue_report/2011-10-26-SRR_85.pdf.

[8] PricewaterhouseCoopers LLP, *Retail Sales Tax Compliance Costs: A National Estimate Volume One: Main Report*, April 2006, available at http://www.bacssuta.org/Cost%20of%20Collection%20Study%20-%20SSTP.pdf.

[9] *Id.*

[10] *Id.*

[11] *Id.*

[12] *Id.*

[13] *Id.*

The Effect of Simplification on Retailers

Through adoption of the SSUTA, 24 states have already implemented significant simplification of their sales tax laws. This simplification has incentivized collection of sales tax by many remote sellers that currently are not required to collect sales taxes. For example, a large regional retailer with a significant national business through their Internet channel has even made the decision to collect sales tax on remote sales but only in states that have adopted the SSUTA.

Many remote sellers recognize that collecting sales taxes may be a more efficient approach to dealing with the realities of their constantly evolving business model. Nonetheless, their good faith effort to collect sales tax would be undermined by collection authority that did not include significant simplification steps. In any legislation considered by this Committee, the NRF recommends that it should be a goal to protect the simplification measures already adopted by states.

While NRF believes that a modest small seller exemption for remote sales is appropriate, raising the level too high will only exacerbate the potential for inequity between a small remote retailer that does not have to collect any taxes and a local small retail competitor who must collect sales taxes on the first dollar of sales. It may be fair for Congress to consider vendor compensation as an alternative to a higher small seller exemption. Congress should resist the temptation to envision that a small seller exemption is the easy answer to meaningful small business regulatory relief.

Alabama has long been notable for its complex sales tax structure retailers collect and remit to local governments. Yesterday, the Alabama Streamlined Sales and Use Tax Commission approved a preliminary plan to simplify the state's sales tax collection system. In news reports, Bruce Ely, an Alabama tax attorney, praised the plan as a step to relief for retailers: "These poor folks are not only covered up in red tape, but they're also covered up with auditors."[14] While not every state has a sales tax regime as burdensome as Alabama, Congress should strive to help retailers remove the "red tape" and auditors in every state.

Current Sales Tax Fairness Legislation before Congress

Three bills have been introduced this session of Congress to address the issue of sales tax fairness. The three bills are:

(1) Main Street Fairness Act of 2011, H.R. 2701, sponsored by Ranking Member Conyers (D-MI-14), has evolved over the last ten years and allows states who adopt the SSUTA to require that out-of-state sellers collect sales tax on merchandise sold to residents of their state. The SSUTA contains significant simplification of state and local sales tax laws, including uniform statewide tax base; uniform sourcing and attribution rules; single, statewide administration of all state and local sales and use taxes; vendor compensation; small business exception; uniform definitions of products and exemptions; and uniform notice and audit procedures. The Streamlined

[14] Martin Swant, *Alabama Streamlined Sales and Use Tax Commission approves preliminary plan to simplify system*, The Birmingham News, posted Nov. 29, 2011 at 6:16 a.m., available at http://blog.al.com/businessnews/2011/11/alabama_streamlined_sales_and.html.

Sales Tax Governing Board sets the exemption limit for small remote sellers and requires partial reimbursement for costs related to collection of sales tax paid by the states to all sellers (brick-and-mortar and remote).

(2) Marketplace Fairness Act of 2011, S.1832, sponsored by Senators Enzi, Durbin, Alexander and Tim Johnson provides a path for states to collect sales tax that incorporates a combination of either nine simplification steps or adoption of the SSUTA. The Marketplace Fairness Act exempts remote sellers with less than $500,000 in remote U.S. sales, requires a single audit by states and localities within a state, requires a single state tax rate based on the destination of the sale, states must establish certification procedures for software and service providers (to calculate rates), and gives remote sellers liability protection for relying on incorrect information supplied by service providers.

(3) Marketplace Equity Act of 2011, H.R. 3179, sponsored by Representatives Womack and Speier allows states to collect sales taxes from remote sellers if they meet three minimum simplification requirements. These three simplification requirements may be met in an interstate agreement, presumably including the SSUTA. Sellers with less than $1 million in remote U.S. sales or $100,000 in remote sales into a particular state are exempted. The three simplification steps are: (1) a single revenue authority within a state for submission of a return; (2) a single tax base set by the state; and (3) the state must choose a single tax rate from three choices: a blended rate of state and locality rates, the maximum state rate, or the destination rate.

Each bill grants states the authority to require remote sellers to collect sales tax on transactions into their respective state if simplification steps are adopted. The varying simplification requirements include tax base, tax rate, and collection software requirements. In our view, all three bills are constructive proposals for a solution to the sales tax fairness issue; however, none of the bills solve all of the problems. We generally prefer the "hybrid" structure of the Marketplace Fairness Act and Marketplace Equity Act, which will allow states to choose between a state-based solution like the SSUTA or a set of federally mandated minimum simplification steps before gaining collection authority on remote sales. At the same time, the NRF recommends that Congress encourage states to adopt many of the strong simplifications measures outlined in Representative Conyers' Main Street Fairness Act in exchange for collection authority on remote sales ensuring that federal legislation does not unwittingly reverse the progress states have made toward simplification up to this point. Finally, we caution that technology alone cannot solve all of the compliance burdens for retailers, and it will be important for the Committee to carefully consider how legislation that relies heavily on software solutions will function in the real world.

**Conclusion**

The National Retail Federation has long supported sales tax fairness legislation, and we are encouraged by the momentum that is building toward a solution. We look forward to working with the Committee on legislation that grants collection authority to states along with simplification steps to ensure effective and fair sales tax collection while relieving burdens placed on a growing sector of the economy.

**Hearing Statement of the**

**National Governors Association to the**

**Committee on the Judiciary, U.S. House of Representatives**

**"Constitutional Limitations on States' Authority to**

**Collect Sales Taxes in E-Commerce"**

**November 30, 2011**

The National Governors Association (NGA) urges Congress to level the playing field between out-of-state and in-state retailers by authorizing states to require remote vendors to collect state sales taxes.

Specifically, governors are encouraged by the introduction of the "Main Street Fairness Act", (H.R. 2071 and S. 1542), the "Marketplace Equity Act," (H.R. 3179), and the "Marketplace Fairness Act" (S. 1832). Although different, each bill would authorize states to require the collection of sales taxes in return for the implementation of tax simplifications that can help all businesses and create fairer competition for consumers.

For states, each bill represents the opportunity to collect more than $22 billion in sales taxes that are already owed by consumers, but not collected. This collection gap was created by U.S. Supreme Court rulings in *Bellas Hess v. Illionis* and *Quill Corp. v. North Dakota* that say a state may not require a seller that does not have a physical presence in the state to collect tax on sales into the state. Consequently, the requirement to pay taxes on remote sales falls to consumers in the form of "Use" taxes, which are filed with year-end tax returns and are often complied with as an exception rather than a rule.

This problem is compounded by the explosive growth of the Internet, which allows remote businesses to compete with local brick and mortar stores for local customers. During the recent recession, Internet sales continued to grow at a double digit rate with total sales

expected to exceed $250 billion by 2014. As such, the Internet encourages tax avoidance; the lack of an effective system to collect sales taxes at the time of purchase causes many Americans to incur – but not pay – the taxes they legally owe.

NGA calls on Congress to examine the different proposals pending before it and move ahead with legislation that will help states modernize their sales tax systems and bring them into the 21st century. Specifically, NGA recommends that the legislation include a specific and clear grant of authority to states to require remote vendors to collect sales taxes; provide a small business exception that exempts genuinely small businesses from collection requirements; avoid impinging on states' authority to establish or remove a tax or set rates it finds appropriate; and not limit state authority over other forms of state taxation.

**Background:**

The Streamlined Sales and Use Tax Project (Project) was initiated by NGA and the National Conference of State Legislatures in the fall of 1999. The goal of the Project was to find solutions for the complexity in state sales tax systems that resulted in the U.S. Supreme Court holding that a state may not require a remote seller without a physical presence in the state to collect tax on sales into the state.

As a result of these decisions, local brick-and-mortar stores operate at a competitive disadvantage with remote sellers who do not collect sales taxes. Local stores find themselves serving as showrooms for Internet and catalog sellers. Prospective customers check out the merchandise locally then buy the product online or through a catalog to avoid paying sales tax.

To address this problem, the Project generated the Streamlined Sales and Use Tax Agreement (SSTA), a cooperative effort of 44 states, the District of Columbia, local governments and the business community to simplify sales and use tax collection and administration by retailers and states. The SSTA minimizes costs and administrative

burdens on retailers that collect sales tax, particularly retailers operating in multiple states. It also encourages "remote sellers" selling over the Internet and by mail order to voluntarily collect tax on sales to customers living in states that comply with the SSTA.

To date 1,736 retailers have volunteered to collect sales tax in Streamlined states and have remitted more than $900 million in sales taxes that would previously have gone uncollected. This amount, however, pales in comparison to what could be collected under a nationwide system authorized by Congress through federal legislation.

**Federal Legislation:**

NGA has supported several different bills over the years to grant states collection authority over remote vendors. As stated above, NGA's support for legislation is not tied to specific legislation, but to core elements that governors believe should be part of any federal grant of authority to states.

First, federal legislation must specifically grant authority to states to require remote vendors to collect sales and use taxes on sales of taxable products and services into their jurisdiction. More importantly, since the grant of authority is tied to meeting certain simplifications, the legislation should recognize the efforts of states which are compliant with the SSTA by granting them the authority to collect immediately. If an alternate path is offered for non-SSTA states, the requirements must be clear so as to avoid litigation when the state makes changes to gain collection authority.

Second, the legislation should include a de minimis or small business exception that exempts genuinely small sellers from the collection requirements. While governors have never specified a level for the small business exception, the size of the exception should be sufficient to relieve the smallest businesses from collection authority, but small enough to ensure the exception does not swallow the rule. Any exception will preserve a portion of the tax collection gap states are working to close. NGA encourages Congress to set a low small business exception while allowing states to increase the exception as appropriate.

Third, the legislation should not dictate rates or mandate the existence or removal of a sales tax. The ability of a state to manage its own fiscal system is at the core of state sovereignty and our federal system. States should be given maximum flexibility to determine the structure and level of taxation while meeting certain simplifications that promote efficiency and enhance the ability of sellers to collect and remit sales taxes.

Fourth, NGA will oppose efforts to combine collection authority with new limits or restrictions on a states' authority over other forms of taxation. Bills such as the Business Activity Tax Simplification Act (H.R. 1439) are antithetical to efforts by states to modernize their tax systems because they seek to revert other tax nexus requirements back to a physical presence standard from which sales taxes are trying to evolve. This and other efforts which would effectively reduce state taxes through federal legislation should not be the cost-of-doing-business for modernizing state sales tax systems.

**Conclusion:**

The National Governors Association supports congressional efforts to grant states collection authority over remote vendors because it will help states close a tax gap that is costing states billions every year, help small businesses comply with the law and expand their business and assist consumers through fair competition.

At a time when states have already closed budget gaps of $325 billion from fiscal years 2009 through 2012, and still face gaps of at least $40 billion for fiscal year 2013, collecting taxes owed means more money for basic services such as roads, schools, teachers and police officers without increasing the federal deficit.

For business, it means that the corner store is on the same footing with the online retailer. In other words, the local sporting goods store that sponsors the neighborhood little league team has the same requirement to collect sales taxes as the big online merchant. It also

means that corner store can grow its business more easily. Simplified tax requirements make doing business easier by reducing risk and creating opportunity.

The legislation also helps consumers. Fair competition means more choice. The success of electronic commerce should not mean the death of Main Street. Instead, our laws should set the stage for all businesses to compete and succeed.

**Hearing Statement**

**Federation of Tax Administrators**

**Constitutional Limitations on States' Authority to**

**Collect Sales Taxes in E-Commerce**

**Committee on the Judiciary**

**House of Representatives**

**November 30, 2011**

The Federation of Tax Administrators (FTA) is an association of the tax administration agencies in each of the 50 states, the District of Columbia, and New York City. We strongly support both the Market Place Equity Act (H.R. 3179) and The Market Place Fairness Act (S. 1832). We very much appreciate the Committee on the Judiciary's interest in remote seller sales tax collection authority. Both bills offer a realistic framework for large and small states to collect sales taxes, already legally imposed, in a simplified administrative system.

The need for this legislation is the result of the U.S. Supreme Court rulings under the dormant commerce clause doctrine that sales and use tax collection duties can only be imposed by the states where the seller has some kind of physical presence. While the Court expressed concern that this rule would effectively exclude an ever-growing segment of the retail economy from sales tax, the Court also noted that Congress could address the issue through its power under the Commerce Clause. The FTA has long regarded this issue to be a matter of the highest importance. This legislation will significantly improve tax compliance for both large and small states as well as local governments. At the same time the legislation will create a level playing field for brick-and-mortar businesses in a state and out-of-state businesses selling into that state.

FTA believes these bills, while somewhat different, can be blended together to provide a solid administrative framework that will create significant benefits for

businesses in terms of required state tax simplifications, while at the same time minimizing implementation and administration burdens on states beyond those that are essential to achieving those simplifications. To the extent we can provide technical expertise to Congress to assist in enacting final legislation as quickly as possible, we stand ready to do so. To that end we offer the following technical comments for the development of a final bill:

1. We support the flexibility that the bills provide for states to structure their own sales taxes in a simplified system. While states have made great strides in creating more uniformity, a federal requirement that all states adopt comprehensive uniformity requirements has proven to be a substantial burden for some states, particularly large states, preventing the adoption of more critical simplifications like those contained in these bills. The approach taken in H.R. 3179 and S. 1832 provides an essential flexibility for all states to be able to enact into law the critical simplifications necessary to qualify for remote seller sales tax collection and remittance authority.

2. We support allowing the states to determine vendor compensation. As drafted, both bills avoid requiring that states provide assistance to vendors in the form of vendor compensation. (Currently 28 states provide some form of compensation.) This leaves the question of whether vendors should be compensated for collecting taxes, and how much, up to the states to consider based on a number of factors such as burdens imposed, vendor size, other types of assistance offered, the size of the particular state's market, etc. Other proposals that would have imposed a specified compensation scheme have not been acceptable to at least some of the larger-market states.

3. We support retention of authority to apply tax rates on either an origin or destination basis. As drafted, both bills preserve state authority to impose tax rates based on the seller's or the customer's location, which is often important for maintaining existing state and local government funding structures.

4. We are concerned that the bills should explicitly retain state authority to impose use tax directly on the purchaser. States should retain the authority they currently have to collect use tax directly from the purchaser where the purchaser buys a good or service without paying sales or use tax to any state, then brings that good or product into a state where the tax is imposed. Use taxes that are required to be paid by purchasers prevent purchasers from evading sales taxes. Because the bills generally do not distinguish sales taxes from use taxes and also provide rules for when a sale is in a particular state for purposes of requiring remote sellers to collect the tax (see the sourcing rules under H.R. 3179 Sec. 5 (4) and S. 1832 Sec. 6 (8)), it could be argued that the bills effectively limit imposition of the use tax by other states. To avoid this confusion, the bills should explicitly reserve authority to the states to impose the use tax in the same way it is currently imposed.

5. We suggest that states be allowed to designate transaction taxes under the legislation. We believe the legislation should allow states to, consistent with the intent of the Act and its scope as defined, designate the specific taxes or the separate elements of their taxes that will be subject to the Act. This will create greater flexibility, greater clarity and will not have an impact on the goal of the bill since authority will only be granted for taxes that comply with the Act's requirements.

6. We are concerned that states retain authority to require record keeping for tax purposes. Sourcing rules under the bills, and particular those under S. 1832 (see Sec. 6 (8)), could be interpreted as relieving sellers from the typical record-keeping requirements imposed on all taxpayers generally or those imposed under state sales taxes. Because the requirement of record keeping for tax purposes is an essential component of any federal, state or local tax system, the states would prefer that a provision be inserted in the legislation to make explicit that the bill does not override record-keeping requirements imposed by

state law.

7. We suggest that Congress consider ways for states to retain flexibility in granting geographic-based exemptions or exemptions for a portion of the state and local tax. To the extent possible, states want to retain authority to provide sales tax exemptions for goods and services used in certain locations within the state in order to promote economic development. They would also like to retain as much authority as possible to grant statewide exemptions from state, but not local taxes, and visa versa, on discrete categories of items in order to provide tax incentives while still maintaining funding for certain governmental functions. The requirement of a uniform tax base in both bills appears to prevent this. Without this flexibility, larger states may have great difficulty conforming to the requirements of the bills. The states would like to work with Congress to see if a solution to this issue can be reached without compromising the simplification that the bills are seeking.

8. We support a small seller exception and suggest that it may be structured in a particular way to best achieve the intended purpose. The states support the inclusion of a small seller exception. Not only does this reduce the burden on smaller remote sellers, but it also avoids the costs of enforcement and compliance, which may not be warranted. The states have three concerns with the structure of the exceptions as drafted: 1) the exceptions should be calculated to gauge the overall size of the business, not just its remote sales, otherwise large sellers who have a small component of their business conducted remotely may be excluded (neither bill does this); 2) there should be explicit authority for states to raise the small seller threshold in order to further limit the number of small sellers subject to collection and remittance requirements; and 3) there must be a provision in any final legislation for attributing sales to related entities in order to avoid manipulation and abuse, such as the provision in S. 1832, Sec. 3 (c), but not in HR 3179.

9. We have a concern that the legislation is ambiguous with respect to what information states are required to provide to remote sellers. It appears that the intent under both bills is for states to provide location-specific rate information to remote sellers on which sellers may rely and be held harmless in subsequent audits if the rate software produces an error. We support the hold harmless benefit for this rate determination function but believe it should be limited to that function. If states already provide or choose to provide additional information, such as tax determinations for particular sales, it should be clear that the "hold harmless" protection does not extend to this additional information.

10. We are concerned that states should not be in a position of providing software or services that the market can and does provide or choosing which software or service providers are "certified." There is no need for the federal bill to require states to be in charge of providing tax reporting software or sanctioning or certifying tax reporting software or service providers or similar businesses. Nor should states be required to provide information to software or service providers or "marketplace service providers," other than location specific rate information, that is not provided to the public generally. States should be allowed to work with software and service providers as necessary without hindering innovation or competition among them. Advances in technology or by new e-commerce business models may make any requirements obsolete.

11. We have minor concerns over delays in commencement of authority. Depending on what is required to commence authority under the Act, there may be a delay of as much as two years in states being able to benefit. (For example, if legislative action is required, Texas would need to wait for its legislative session, which happens only every two years.) There does not seem to be any purpose served by delaying authority for states that already meet the requirements beyond what is necessary to provide notice to remote sellers.

12. We have a serious concern over termination of authority and the need for any determination of state noncompliance to be made on an expedited basis. A challenge to state authority under the Act might take years to resolve, and during this time, the validity of the tax may be in question. We would therefore prefer it if there were some expedited means for states themselves or for taxpayers to raise any issue about whether states have made minimum simplifications. Also, it should be explicit that termination of authority is effective as of the date that a final determination of noncompliance is made.

13. We suggest a restructuring of provisions related to "marketplace service providers" (MSPs) be considered. We suggest that Congress consider a different approach to how MSPs are treated. MSPs could be required to collect and remit sales taxes with respect to sales made through them by third party vendors without regard to whether the small seller exception applies to those vendors. Vendors would be relieved from potential tax liability if they use a registered MSP in good standing with the state.

14. We prefer the definition of "remote sale" in H.R. 3179 as opposed to S. 1832. S. 1832 refers to *Quill*, but *Quill* addressed a specific set of facts, that is mail-order sellers, and did not address other circumstances where a remote seller might have tax nexus, such as when the seller is represented in the state by a third party salesman. See *Tyler Pipe v. Wash. Dep't of Rev.*, 483 U.S. 232 (1987).

15. We suggest that S. 1832 be modified to allow local rate changes effective on the first day of any month and not just on the first day of a calendar quarter. Not all state systems are based on a calendar year schedule. A fiscal year cycle can be used. A rate change based on a calendar year system will place fiscal year systems in a position where rate changes will occur in the middle of the quarter

or other rate period. This type of change will cause significant administrative problems that can be avoided by replacing the current rate change requirement based on calendar year quarters with a requirement that changes occur at the beginning of a month.

Thank you for the opportunity to submit written comments on the important subject of remote seller sales tax collection authority for states. We look forward to working with Congress to enact this important legislation into law as soon as possible.

November 29, 2011

The Honorable Lamar Smith
Chairman
Committee on the Judiciary
U.S. House of Representatives
Washington D.C. 20515

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

Dear Chairman Smith and Ranking Member Conyers:

The organizations listed above appreciate the opportunity to submit this letter about the importance of allowing states and local governments to collect taxes on sales made through e-commerce. Our organizations, representing local governments, have long called for the authority to collect taxes on sales made by remote means – whether catalogue mail or phone sales in the 80s and 90s, or the changing environment to on-line sales over the Internet, which continues to grow and capture an increasing amount of the shopping marketplace today.

Billions of sales tax dollars are lost each year by continuing to allow a tax-free platform to exist for Internet purchases, an unfair advantage to the shopkeepers on main streets throughout the country, who must collect those taxes. We have asked for – and have worked towards – ensuring that a fair and more efficient system comes into place so that there is a level playing field between e-commerce and brick and mortar businesses.

There is no better time than now – when local governments and states are continuing to find ways to mitigate the difficulties brought on by the financial crises of the country over the past few years – to grant authority for remote sales tax collection. Simply, taxes should be collected on goods regardless of the method in which they are purchased. It is not a new tax – these taxes are already owed. Additionally, unlike in 1992 when the Supreme Court decided *Quill Corp. v. North Dakota*, technology is readily available for retailers to determine the appropriate tax rates without undue administrative or costly burdens. The time has come for a level playing field.

We are especially supportive of three bills that would allow for the collection of taxes on remote sales, and preserve the important and hard work achieved by the Streamlined Sales Tax Agreement Project – *The Main Street Fairness Act* [H.R. 2701 (introduced by House Judiciary Ranking Member Conyers) and S. 1452], and the *Marketplace Fairness Act*, a bi-partisan bill recently introduced in the Senate by members who have been closely involved with this issue for many years, S. 1832.

However, we have strong reservations about H.R. 3179, the *Marketplace Equity Act of 2011*, which does not preserve the ability for each local government to collect sales and use taxes at their current rates. Instead, it could eliminate local sales tax rates altogether or incorporate a blended local rate. This means that the sales and use rates currently set by the elected officials and citizens of each local entity would either be ignored or altered, pre-empting local government's ability to establish their own sales and use tax rates.

For decades we have worked to allow for local and state remote sales tax collection. The convergence of capable technology and the importance of leveling the playing field between shopkeepers on main street and the Internet have never been greater. We respectfully request that Congress move forward with legislation that preserves state and local taxing authority, while granting them the ability to rightfully collect taxes that are already owed on remote sales.

Sincerely,

Larry E. Naake, Executive Director
National Association of Counties

Donald J. Borut, Executive Director
National League of Cities

Tom Cochran, CEO and Executive Director
United States Conference of Mayors

Jeffrey L. Esser, Executive Director and CEO
Government Finance Officers Association

Gap Inc.

GPS Services
2 Folsom Street
San Francisco, CA 94105

November 30, 2011

Congressman Lamar Smith
Chair, House Judiciary Committee
2138 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Smith,

On behalf of Gap Inc., I am writing to express our strong support for H.R. 3179, the Marketplace Equity Act. This legislation provides a nationwide solution that levels the playing field for brick-and-mortar businesses by closing a loophole that provides a competitive advantage for online-only retailers.

Founded more than 40 years ago in San Francisco, California, Gap Inc. now employs more than 100,000 people around the country in our five brands: Gap, Banana Republic, Old Navy, Piperlime and Athleta. Our annual revenue is approximately $15 billion. Working with our California coalition members, we were pleased to recently reach a compromise solution in our state that would allow us to work with online-only retailers on a lasting solution at the Federal level.

The Marketplace Equity Act simply gives states the right to collect, or to decide not to collect, sales and use taxes that are already owed under current state law by allowing individual states to become members of the Streamlined Sales and Use Tax Agreement or to adopt minimum simplification requirements.

As the president of Gap Inc.'s e-commerce division, I am highly aware of the benefits of the Marketplace Equity Act. Here are a few key points as to why Gap Inc. supports a federal solution:

- **Not a New Tax:** This is an existing tax that every consumer is required to track and report. This legislation will close a loophole that online-only retailers are exploiting by not collecting sales tax at the point of sale despite the fact that the tax is still due; and brick-and-mortar businesses, small and large, are at a significant disadvantage as they are collecting the tax as required by law.

- **Only Congress Can Act:** Only Congress has the ability to provide a comprehensive solution -- one that allows the states to enforce their sales tax laws on all sales in their state. The Senate bill provides a way for states, such as California, to require that online retailers collect both state sales taxes and the local supplemental taxes.

- **Fix Faulty Public Policy:** It is simply unfair that companies like ours are disadvantaged by sales taxes up to 8.5 percent on our goods as compared to online only companies like Amazon, especially given that we invest in the communities where we have a physical presence, that we employ many Americans, and that we contribute to downtowns and shopping centers.

- **Level the Competitive Playing Field:** Retailers thrive on competition, and a comprehensive federal solution for online sales tax collection will foster a business climate that treats competitors equally. A level playing field for all retailers will stimulate increased competition, provide consumers with better prices and foster a positive job climate.

Thank you for your consideration of our position, and please let me know if I can provide any additional information.

Sincerely,

Toby Lenk
President, Gap Inc. Direct

Cc: Glenn Murphy
Chairman and Chief Executive Officer, Gap Inc.

John Fisher

Congresswoman Jackie Speier



International Council of Shopping Centers

UNITED STATES
HOUSE OF REPRESENTATIVES

COMMITTEE ON THE JUDICIARY

# Hearing on Constitutional Limitations on States' Authority to Collect Sales Taxes in E-Commerce

STATEMENT OF THE INTERNATIONAL COUNCIL
OF SHOPPING CENTERS

NOVEMBER 30, 2011

The International Council of Shopping Centers ("ICSC") is pleased that the full Judiciary Committee of the House of Representatives is holding a hearing on this timely topic of "Constitutional Limitations on States' Authority to Collect Sales Taxes in E-Commerce". Founded in 1957, ICSC is the premier global trade association for the shopping center industry. Its more than 55,000 members in over 90 countries include shopping center owners, developers, retailers, investors, lenders and other professionals as well as academics and public officials. One of out every 11 U.S. jobs is shopping center-related; for every 100 individuals directly employed at regional shopping centers, an additional 20 – 30 are supported in the community due to multiplier effects. ICSC has had a long standing commitment to creating a fair and level playing field for all retailers, whether they sell online, in a mall or shopping center, or on Main Street.

In the nascent stages of Internet retailing, ICSC began advocating at the state level for what was then called "e-fairness". At the time, the focus of our efforts was to encourage states to join the Streamlined Sales and Use Tax Agreement (SSUTA), a collaboration among 44 states, the District of Columbia, local governments and the business community. The Streamlined Sales and Use Tax was the product of the National Governor's Association (NGA) and the National Conference of State Legislatures (NCSL) in the fall of 1999 to simplify sales tax collection. The laudable goal of the SSUTA is to simplify sales and use tax collection and administration by retailers and states. To date, 24 out of the 44 states have passed SSUTA conforming legislation. The Agreement minimizes costs and administrative burdens on retailers that collect sales tax, particularly retailers operating in multiple states. It encourages "remote sellers" selling over the Internet and by mail order to collect tax on sales to customers

living in the streamlined states and it levels the playing field so that local "brick-and-mortar" stores and remote sellers operate under the same rules. While 1400 retailers voluntarily collect sales tax in streamlined states, to the tune of $700 million, that is just the tip of the iceberg. In order to collect the full amount due under existing law, Congress must enact authorizing legislation so that states can require out-of-state sellers to collect and remit appropriate taxes. (see *Quill Corp. v. North Dakota, 504 U.S. 298).*

ICSC commends Ranking Member Conyers and Congressman Hank Johnson for their leadership in cosponsoring H.R. 2701, the "Main Street Fairness Act", which provides the necessary authorization for streamline states. Their efforts opened the door for two other bills on the issue – H.R. 3179, the "Marketplace Equity Act" and S. 1832, the "Marketplace Fairness Act" provide alternative approaches to the 21 remaining sales tax states that have not, for various reasons, chosen to join the SSTUA.

H.R. 3179 authorizes states to require all out-of-state sellers making remote sales to collect and remit sales and use taxes for sales into the state, without regard to the location of the seller if such states implement a simplified system for administration of sales and use tax collection for remote sellers.

The minimum requirements for the simplified system include: (1) an important exception for remote sellers with gross annual receipts in the preceding calendar year from remote sales not exceeding $1 million in the United States or not exceeding $100,000 in the state; (2) a single sales and use tax return for use by remote sellers and a single revenue authority within the state with which remote sellers are required to file a tax return; and (3) a uniform tax base throughout the state. The authorization begins

approximately 6 months after the state makes public notice of the new collection system.

S. 1832 is rooted in giving states the ability to enforce their sales and use tax laws and to treat similar sales transactions equally, without regard to the manner in which the sale is transacted, and the right to collect--or decide not to collect--taxes that are already owed under State law. Under the Senate bill, each streamline state may begin requiring remote sellers to collect and remit sales and use taxes 90 days after enactment. As with H.R. 3179, the legislation also provides an alternate path for non-streamline states by setting forth a set of minimum simplification requirements. Once met, those states can begin requiring collection and remittance 6 months after states ratify and implement the simplification system. Both House and Senate legislation have exemptions for the small seller. ICSC commends and supports the bipartisan members who have provided leadership on these bills, which empower states to craft sales tax collection in an efficient manner that works best for that particular venue.

We hope the Committee will take the proposals under serious consideration and move much needed authorizing legislation. Much is at stake, for the country's fiscal well-being and quality of life for your constituents. According to the University of Tennessee's Center for Business and Economic Research estimate, states are expected to miss out on an as much as $23 billion in uncollected sales tax in 2012 alone. This potential revenue stream could lessen states dependency on the federal government for financial assistance. Furthermore, the collection of taxes owed could help states make needed infrastructure repairs, assist schools, libraries and other

essential services the people who you represent depend upon – all without costing the federal government a dime.

Another important risk factor if this loophole is left unchecked is the long term effect on job creation. Each $1 million of new retail sales in traditional brick-and-mortar establishments adds 3.61 jobs. The same $1 million in new sales at an Internet-only retailer is expected to create 0.88 jobs. Local retailers hire our family members and contribute to our communities. But these businesses can't compete under current conditions with online giants that don't collect sales taxes and don't have a local presence in our neighborhoods. Unless the system is corrected, local retailers will become endangered species as will the jobs that they bring to their communities.

Finally, we are no longer in the start-up phase of on-line retailing. The shopping center industry recognizes Internet sales will only continue to grow resoundingly. Since 2000, U.S. e-commerce has had a compound annual growth rate of 19%. Over the next ten years, Goldman Sachs projects that the e-commerce compound annual growth rate will be five times the rate of traditional retailing with 15% for e-commerce vs. 3% for traditional retail. On that basis, in 2020 e-commerce sales will equal 17% of total U.S. retail sales, compared with 5-6% now. It is time for Congress to close the tax subsidy that gives one retail segment as much as a 10% competitive advantage over another. Betsy Burton, owner of The King's English Bookstore, an independent book seller in Utah said it best: "It's time for people to stop thinking about this as a new tax - - which it isn't - - and start thinking about it as a fairness issue, which it is."

ICSC respectfully asks your consideration to pass H.R. 3179 and create a level playing field for all retail entrepreneurs to thrive. Thank you.

**FEDTAX**

PREPARED TESTIMONY SUBMITTED FOR THE RECORD OF

# THE UNITED STATES HOUSE OF REPRESENTATIVES COMMITTEE ON THE JUDICIARY

PUBLIC HEARING REGARDING

## CONSTITUTIONAL LIMITATIONS ON STATES' AUTHORITY TO COLLECT SALES TAXES IN E-COMMERCE

NOVEMBER 30, 2011

TESTIMONY BY

**R. DAVID L. CAMPBELL**

*CHIEF EXECUTIVE OFFICER, THE FEDERAL TAX AUTHORITY, LLC*

### I. BACKGROUND

My name is David Campbell. I am the chief executive officer of the Federal Tax Authority, or FedTax, founded in 2008. We are a Washington State Limited Liability Company with operations in Washington, Connecticut, and Kansas. Our management team includes highly experienced professionals who have been directly involved in building some of the most recognizable brands in e-commerce, including MasterCard, Google, WebMD, Microsoft, Expedia, and American Express. FedTax has been designated a Certified Service Provider by the Streamlined Sales Tax Governing Board specifically for our TaxCloud service, which I will discuss further in a moment.

### II. PURPOSE

My purpose of these remarks is to provide technical information for Congress to consider when evaluating the matter of sales tax collection by remote retailers. The two main arguments against granting states the authority to require remote retailers to collect sales tax are that: a) compliance would be overly burdensome and complex, and b) that any systems necessary for compliance would be prohibitively costly.

### III. THE COMPLEXITY ARGUMENT

The notion that out-of-state retailers would find it overly burdensome to keep track of every state's sales tax rules can be traced directly back to the 1967 Supreme Court ruling in *National Bellas Hess v. Illinois Department of Revenue*. In its majority opinion, the court ruled that "the **many variations in rates** of tax, in allowable **exemptions**, and in administrative and **record-keeping requirements** could entangle National's interstate business in a virtual welter of complicated obligations to local jurisdictions" (emphasis added).

We frequently cite this quote because it summarizes the ruling's basis in complexity and burden, which has rippled forward to the present day and created a tidal wave of unintended consequences. This ruling has shielded all out-of-state retailers from the obligation to collect sales tax, based purely on the notion that it would place too much of a burden on businesses—and perhaps it would have, in 1967. That was the year the floppy disk was invented at IBM. It was also one year before Gordon Moore and Robert Noyce founded Intel, and one year before Dr. Larry Roberts published a plan to develop ARPANET, which laid the foundation for the internet we know today.

In 1992, the matter of remote sales tax collection came before the Supreme Court again in *Quill v. North Dakota*. This time, the court reaffirmed the earlier *Bellas Hess* decision by a ruling of 8 to 1, primarily on the basis of *stare decisis* ("to stand by decision," a doctrine that requires the court to respect the precedent set by prior rulings). The ruling went on to state, "[O]ur decision is made easier by the fact that the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve. No matter how we evaluate the burdens that use taxes impose on interstate commerce, *Congress remains free to disagree with our conclusions*" (emphasis added).

Technology has advanced considerably since the Supreme Court rulings in 1967 and 1992. Even the more recent of these was before the first graphical browser was invented, before most homes had internet connections, and long before e-commerce forever changed the retail landscape. Today, forty-four years after Bellas Hess and nineteen years after Quill, online marketplaces and auction sites, such as those operated by several of the witnesses before you today, easily manage millions of items for sale at any given moment. Today, keeping track of a few thousand local tax rates and filing requirements is no longer an insurmountable technical, administrative, or financial burden. TaxCloud, the sales tax management system created by FedTax, is the first nationwide system to prove this point by calculating and collecting sales tax for every tax jurisdiction in the United States *at absolutely zero cost to retailers*.

Technology has even eliminated any hurdles standing in the way of achieving a truly easy-to-use sales tax system, one that could simultaneously respond to retailers' requirements and maintain state and local governments' ability to respond to and respect the will of their constituents in the manner in which they consent to be taxed, in what amount, and for what purpose.

The technologies and techniques necessary to create such a system are not new: in fact, they are already well-established, in fact they are currently being used throughout e-commerce. They are Application Programming Interfaces and Web Services. An Application Programming Interface (or API) allows dissimilar and unrelated systems to communicate with each other using pre-established syntax and structure. Web Services allow APIs to be relied upon for machine-to-machine interactions over the Internet. An example of APIs and Web Services now common in e-commerce is "real-time-shipping." With real-time shipping, a retailer can provide its customers with accurate, real-time quotes for shipping costs based on at least five variable factors, including weight, size, delivery speed, origin, and destination. Often customers can even compare the costs of shipping with multiple shippers. With APIs, Web Services, and other technological advances of the past twenty years, it's possible to make it easy for remote retailers to keep track of every state's tax laws.

Ironically, the most vocal proponents of the complexity argument are primarily large online businesses that already rely on these same technologies and techniques every day, in every transaction they make possible. The plain fact is that eBay operates the largest marketplace in the history of the world by relying on technology to simplify and automate a host of historically burdensome chores, including payment automation, location-specific marketing, personalized recommendations, and even Duties and Value Added Tax management for foreign transactions.

## IV. THE COSTS-OF-COMPLIANCE ARGUMENT

Opponents also argue that even if technology can solve the technical burden of keeping track of rates, jurisdictions, and filing complexities, such software would be prohibitively costly, particularly for small businesses. TaxCloud is provided to retailers at no cost—so the argument that such software would be prohibitively costly should be flatly disregarded. However, the costs-of-compliance argument also maintains that even if the software is free, businesses will still be burdened with the cost of integrating such software into their existing systems.

This line of argument ignores the reality that all but the very largest retailers rely upon pre-written software and/or online hosted platforms for e-commerce and order management. Retailers rely upon these systems to avoid the costs of developing, managing, and maintaining such systems on their own, costs that are magnified by the changing nature of e-commerce. It is no secret that e-commerce is constantly changing to respond to evolving cyber-crime threats, payments and security industry best-practices, and, yes, even legislative requirements. When their retailer clients need to collect sales tax, platform vendors will provide ways for them to do so, embedded within the platforms that retailers already use.

E-commerce platform vendors are intensely competitive and focused: they take pride in not only achieving compliance with evolving requirements but often surpassing them, occasionally with stunning results. For example, much of the cloud computing infrastructure now transforming every corner of the technology sector can be traced to several of the largest e-commerce companies adapting to comply with the Sarbanes Oxley Act of 2002. They will respond equally competitively to provide sales tax management services for their clients.

An analogy can be made to the automotive industry. There are many cars on the road today, but almost all of them were produced by an easily identifiable group of manufacturers. In 1968, a federal law was enacted requiring seatbelts in cars. Ignoring the role of manufacturers, proponents of the cost-of-compliance argument would have portrayed a situation in which every car operator in the United States had to pay for and install seatbelts in their cars. Obviously that's not the case; nor is it the case that retailers will need to pay for and install their own systems to handle sales tax collection.

## V. CONCLUSION

To conclude, modern technology has made it easy for retailers to collect sales tax for any state in the U.S. I am proud to say that our service, TaxCloud, enables any retailer of any size to easily collect sales tax and comply with the provisions of every version of legislation under consideration by Congress—for free.

In closing, just three days ago, on Cyber Monday, **over $1.2 billion in sales were transacted online**. On that day alone, **approximately $58 million in sales tax went uncollected**.

Thank you once again for allowing me this opportunity to express our support for action by Congress on this important issue.

R. David L. Campbell
Chief Executive Officer, FedTax.net

TAX FOUNDATION
Since 1937

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# Assessing Federal Action on State Efforts to Collect Sales and Use Taxes on Internet Commerce

By Joseph Henchman
Vice President, Legal & State Projects, Tax Foundation

Hearing on Constitutional Limitations on States' Authority to Collect Sales Taxes in E-Commerce
Before the Committee on the Judiciary,
U.S. House of Representatives

*November 30, 2011*

**Mr. Chairman and members of the Committee:**

You have before you a number of bills that seek to reverse a series of U.S. Supreme Court decisions (most recently the *Quill* decision of 1992) that prohibit states from imposing sales tax collection obligations on businesses with no property or employee in the state. This "physical presence" standard is meant to prevent states from shifting tax burdens to non-residents away from residents who are the primary beneficiary of state services, while also protecting the free flow of interstate commerce from the compliance costs of non-uniform and numerous (9,600+) sales tax jurisdictions in the United States.

The steadily increasing growth of Internet-based commerce has however led to frustration with this standard, primarily due to disparate sales tax treatment of similar goods within states that has no economic basis. This can be addressed while also ensuring that some standard exists to restrain states from engaging in destructive behavior, such as tax exporting to non-voters or imposing heavy compliance costs on interstate businesses, that the Congress is empowered to prevent. Further, because economic integration is greater now than it has ever been before, the economic costs of nexus uncertainty are also greater today and can ripple through the economy much more quickly.

As a 501(c)(3) organization, the Tax Foundation takes no position on any pending legislation. However, substantial progress has been made in recent months toward possible solutions that could (1) simplify sales tax systems and avoid discriminatory compliance costs, (2) eliminate non-neutral tax rates on similar products sold by online and brick-and-mortar businesses, (3) limit taxation in a state to those residents who enjoy the benefits of state services, (4) prevent multiple taxation of interstate commerce, and (5) prevent unconstitutional and fragmented state attempts to impose such tax burdens in a destructive manner.

We hope that the material we provide will be helpful in the Committee's consideration of this issue.

## Recent Developments in Sales Tax on Remote Sellers

In 2010 and 2011, state legislatures across the United States debated the merits of new measures to collect sales and use tax from online merchants. Pushed by in-state retailers and citing fairness concerns and the desire to send a message to Congress, in many states these efforts were able to overcome the fact that these laws do not result in increased revenue and lead to lengthy litigation due to their dubious constitutionality.

So far, Arkansas and Illinois have enacted new so-called "Amazon" tax affiliate nexus statutes, joining New York, North Carolina, and Rhode Island. Colorado and a few other states considered similar laws that focus on mandatory disclosure of tax obligations to consumers, rather than direct collection as in the other states. Debate continues in many other states.

These actions are only the latest chapter in a long saga over the proper tax treatment of sales made over the Internet, and an even longer saga over the proper scope of state taxing authority. At its core is a dispute over which is more important: limiting state power to tax nonresidents and thus harm the national economy, or ensuring that some transactions do not escape tax because they are conducted online. Discussions following a recent compromise in California suggest that there are policy options that could achieve both ends.

## The Constitution Empowers Congress to Limit States' Power to Shift Tax Burdens to Non-Residents

The U.S. Constitution exists in large part because states were disrupting the national economy by using trade barriers and discriminatory taxes against each other. Absent some constraints, states have an incentive to shift tax burdens from physically present individuals and businesses to those who are beyond their borders.

Justice Johnson, concurring in *Gibbons v. Ogden* (1824), wrote that "states' power over commerce,] guided by inexperience and jealousy, began to show itself in iniquitous laws and impolitic measures . . ., destructive to the harmony of the states, and fatal to their commercial interests abroad. This was the immediate cause, that led to the forming of a convention." Gouverneur Morris argued at the Constitutional Convention that "local concerns ought not to impede the general interest. There is great weight in the argument, that the exporting States will tax the produce of their uncommercial neighbors."

Congress thus has the power to restrain states from interfering with interstate commerce, particularly with their taxing power. As Justice Story explained, "[T]here is wisdom and policy in restraining the states themselves from the exercise of [taxation] injuriously to the interests of each other. A petty warfare of regulation is thus prevented, which would rouse resentments, and create dissensions, to the ruin of the harmony and amity of the states." More recently, Professor Daniel Shaviro has noted

that "[p]erceived tax exportation is a valuable political tool for state legislators, permitting them to claim that they provide government services for free."

The **Commerce Clause** prohibits states from imposing a tax on activity out-of-state while leaving identical activity in-state untaxed, a relatively uncontroversial element of the Commerce Clause distinct from the more controversial aspect of the Commerce Clause involving the scope of Congress's power to regulate private activity. The **Import-Export Clause** prohibits states from penalizing activity that crosses state lines, particularly imports. The **Tonnage Clause** prohibits state charges on shipping freight. The **Privileges and Immunities Clause** of Article IV and the **Privileges or Immunities Clause** of the Fourteenth Amendment protects the right of citizens to cross state lines in pursuit of an honest living.

### State Taxation of Interstate Commerce: From Complete Ban to *Complete Auto*

So strong was the concern over state misuse of their power, that the rule for a century and a half was that **states could not tax interstate commerce at all**. *See, e.g., Freeman v. Hewit*, 329 U.S. 249, 252-53 (1946) ("A State is ... precluded from taking any action which may fairly be deemed to have the effect of impeding the free flow of trade between States"); *Leloup v. Port of Mobile*, 127 U.S. 640, 648 (1888) ("No State has the right to lay a tax on interstate commerce in any form.").

This eroded in the 1950s and 1960s as it was recognized that interstate commerce do enjoy benefits in states where they were present, so it is not unfair to have them support those services with taxes. Pushed along by a series of cases treating essentially identical taxes differently based on "magic words" in the statute. For example, an annual license tax imposed on the in-state gross receipts of an out-of-state company was invalidated as discriminating against interstate commerce, but an otherwise identical franchise tax on in-state going concern value, measured by gross receipts, was upheld as valid. *Compare Ry. Express Agency v. Virginia*, 347 U.S. 359 (1954) ("*Railway Express I*") *and Ry. Express Agency v. Virginia*, 358 U.S. 434 (1959) ("*Railway Express II*").

The complete ban on state taxation of interstate commerce was abandoned in 1977, replaced by a recognition that **resident businesses engaged in interstate commerce should pay for the fair share of the state services they consume**. *See Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977) (holding that states may tax interstate commerce if the tax meets a four part test:

- **nexus**, *a sufficient connection between the state and the taxpayer;*
- **fair apportionment**, *the state cannot tax beyond its fair share of the taxpayer's income;*
- **nondiscrimination**, *the state must not burden out-of-state taxpayers while exempting in-state taxpayers;*
- **fairly related**, *the tax must be fairly related to services provided to the taxpayer.*

### Nexus Based on Physical Presence *vs.* Other Proposals

What is nexus for a remote seller? In 1967, the U.S. Supreme Court held that a business does not have nexus with a state if the business has no retail outlets, solicitors, or property in the state, and communicates with customers only by mail or common carrier as part of a general interstate business. *See National Bellas Hess, Inc. v. Dept. of Revenue of Ill.*, 386 U.S. 753, 759-60 (1967). Otherwise, the Court concluded, states could "entangle National's interstate business in a virtual welter of complicated obligations to local jurisdictions with no legitimate claim to impose a fair share of the cost of the local government." This decision was reaffirmed after the *Complete Auto* test was announced in 1977. *See Nat'l Geographic Society v. Ca. Bd. Of Equalization*, 430 U.S. 551, 559 (1977).

During the 1980s, some academics and many states criticized *National Bellas Hess* as archaic, formalistic, and outmoded. Officials were encouraged to ignore the decision, and some state courts disregarded it, even as the number of sales taxes rose from 2,300 to 6,000. Different murky definitions of economic nexus were proposed:

- "Out-of-state company is engaged in exploiting the local market on a regular, systematic, large-scale basis."
- Presence of intangible property or affiliates
- Number of customers in state, value of assets or deposits in the state, and receipts attributable to sources in the state
- Analysis of frequency, quantity, and systematic nature of taxpayer's economic contacts with the state
- Derivation of economic benefits from state's residents

Defying the Court rulings, North Dakota enacted a law requiring the out-of-state Quill Corp. to collect sales tax on its sales to 3,000 in-state customers. Any state that advertised three times in the state was liable. In the case, the U.S. Supreme Court reaffirmed *National Bellas Hess* and *Complete Auto*. *See Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), stating that the physical presence rule "firmly establishes the boundaries of legitimate state authority to impose a duty to collect sales and use taxes and reduces litigation concerning those taxes." Justice Byron White dissenting, arguing two points: (1) injustice that some sales escape taxation and (2) arguing that technological change had made discriminatory compliance costs no longer burdensome.

### Efforts to Change *Quill*

Today, there are over 9,600 state and local sales tax jurisdictions in the United States. There are different rates on different items, they change frequently, and are not even aligned to 9-digit zip codes. States are reluctant to cooperate on even basic rules and definitions.

The **Streamlined Sales Tax Project** (SSTP) was launched in 2000 with the mission of getting states to adopt changes to their sales taxes to make them simple and uniform. SSTP then hopes to convince Congress or the courts to overrule *Quill* and allow use tax collection obligations on out-of-state companies ("Main Street Fairness Act").

However, the SSTP has abandoned simplification efforts and any attempt to reduce the number of sales tax jurisdictions, instead focusing on uniformity efforts. In many cases, the Project has enabled state sales tax complexity by permitting separate tax rates for certain goods. States generally are reluctant to yield parochial advantages, even with the possibility of online sales tax revenue in return, undermining their argument to Congress as part of the **Main Street Fairness Act** that they have succeeded in their mission. Large states have generally avoided the SSTP, and membership has been stuck at 20-something states for some time.

This in turn has led to impatience from states and others.

## Efforts to Defy *Quill*

In 2008, New York adopted an "Amazon" tax, nicknamed after the Internet retailer as the most visible target. The law held that a person or business with no physical presence in the state nevertheless has nexus if it (1) enters into agreement with in-state resident involving commissions for referring potential customers; and (2) has gross receipts from sales by out-of-state company from referrals within the state are more than $10,000 in a 12-month period.

Amazon.com & Overstock.com responded by terminating affiliate programs in New York, and Amazon.com filed a lawsuit in state court. The law was upheld by a trial judge (New York's trial courts are called the "New York Supreme Court," causing confusion about who upheld the Amazon tax as constitutional); the judge concluded that Amazon.com's in-state affiliates are necessary and significant to establishing and maintaining out-of-state company's market in the state. But because they make up only 1.5% of sales, that was the basis for the appeal. The New York Supreme Court, Appellate Division ruled in late 2010 that law is not facially unconstitutional but may be unconstitutional for Amazon. Remanded to lower court, but Amazon appealing to state's highest court, the New York Court of Appeals. The case is ongoing.

In 2009, Rhode Island and North Carolina adopted identical New York-style laws. Neither has seen any revenue and Rhode Island has actually seen revenue loss due to reduced income tax collections from terminated in-state affiliates. Laws were also passed in California and Hawaii but vetoed.

In 2010, Colorado considered the same law but faced opposition from in-state affiliates. Instead it adopted a law (H.B. 10-1193) designed to push Amazon into collecting use taxes without explicitly requiring it. Any out-of-state retailer that is part of "a controlled group of corporations" with at least one member with physical presence in Colorado, all the retailers in the group have nexus with Colorado. However, the "only" obligation with this nexus is notification:

- "[N]otify Colorado purchasers that sales or use tax is due on certain purchases made from the retailer and that the State of Colorado requires the purchaser to file a sales or use tax return." Penalty of $5 per failure per customer, plus criminal penalties
- "[Notify] all Colorado purchasers by January 31 of each year showing such information as the Colorado Department of Revenue shall require by rule and the total amount paid by the purchaser for Colorado purchases made from the retailer in the previous calendar year. Such notification shall include, if available, the dates of purchases, the amounts of each purchase, and the category of the purchase, including, if known by the retailer, whether the purchase is exempt or not exempt from taxation." Must be sent separately from other shipments and be by first-class mail. CC to State. Penalty of $10 per failure per customer, plus criminal penalties.

Amazon.com terminated affiliate programs in Colorado, and the Direct Marketing Association filed lawsuit in federal court. In January 2010, a federal judge stayed the law stayed as probably unconstitutional on First Amendment grounds.

North Carolina followed Colorado by adopting regulation with similar/notification requirements. They demanded out-of-state companies provide them with all customer purchase information dating from 2003, by April 19, 2010. Amazon.com and the ACLU filed lawsuit in federal court, arguing that "[e]ach order of a book, movie, CD or other expressive work potentially reveals an intimate fact about an Amazon customer." Examples of purchases by North Carolina residents:

- *Bipolar Disorder: A Guide for Parents and Families*
- *He Had It Coming: How to Outsmart Your Husband and Win Your Divorce*
- *Living with Alcoholism: Your Guide to Dealing with Alcohol Abuse and Addiction While Getting the Alcoholism Treatment You Need*
- *What to Do When You Can't Get Pregnant: The Complete Guide to All the Technologies for Couples Facing Fertility Problems*
- *Outing Yourself: How to Come out as Lesbian or Gay to Your Family, Friends, and Coworkers*
- *Lolita* (1962)
- *Brokeback Mountain* (2005)
- *Fahrenheit 9/11* (2004)

A federal judge struck down the North Carolina regulation as violating First Amendment in October 2010.

In 2011, Illinois and Arkansas enacted New York-style laws. California enacted one but after a possible repeal referendum was proposed, the state and Amazon.com reached an agreement whereby Amazon.com will develop a physical presence in the state.

## Possible Solutions

### Florida "iStart" Proposal

This state legislative proposal would require the State of Florida to create software ("Internet Sales Tax Automated Revenue Tracking") to enable one-stop sales tax calculation and payment. The state would make it available to retailers selling in Florida and under license to other states. The state would also pay compensation to vendors who collect, and the law prohibits disclosure of purchase information. When revenue from the software exceeds $5 billion per year, the state sales tax is automatically reduced by 1 percentage point.

### Origin-Based Taxation

This proposal is premised on the idea that the taxes one pays are a rough approximation for the government services consumed ("**benefit principle**"). State spending overwhelmingly, if not exclusively, is meant to benefit those who live and work in the jurisdiction. Education, health care, roads, police: the primary beneficiaries are in-state residents.

Thus, individuals and businesses should pay taxes where they work and live; jurisdictions should not tax those who don't work and live there. In practice for sales tax, Amazon.com would collect Washington sales tax on all transactions. Amazon employees use Washington state services. Resident-purchasers of Amazon products pay other taxes to their states.

This solution is in line with brick-and-mortar practice: tax based on where business is, not where customer is from. It levels playing field (as opposed to the Main Street Fairness Act or "Amazon" taxes, where **brick-and-mortar comply only with taxes where they are physically present** while **online companies must comply with thousands**).

While some may criticize origin-based taxation as enabling Internet-based businesses to "escape" taxation by locating in states that do not tax sales, individuals do not all congregate in states with no income tax and corporations do not all congregate in states with no corporate income tax. States compete not only over taxes but over state services, transportation, education, weather, and other factors.

### National Online Sales Tax

If states are unwilling to simplify their tax systems to prevent complexities from being imposed on those engaged in national online commerce, another option would be to implement a single default national sales tax to be imposed on online transactions, with the revenue distributed among the states. This could be on its own or distinct from other options and would eliminate much the disparity between goods purchased in brick-and-mortar stores and goods purchased online. Ideally, implementation should be revenue-neutral, with the revenue collected used to reduce other taxes.

## Marketplace Fairness Act Proposal

The Marketplace Fairness Act, recently introduced, eliminates the physical presence rule but otherwise quite a few advances towards ensuring that states reduce the burdens associated with collecting their sales taxes. Its provisions:

- States that are currently members of the Streamlined Sales Tax Project (SSTP) are permitted to require collection of sales taxes by out-of-state companies.
- States that are not members of the SSTP pact are permitted to require collection of sales taxes by out-of-state companies if they meet the following minimum requirements:
    - A single state-level agency that administers all sales tax rules, collection, and administration, including for local sales taxes in the state
    - A single audit for all state and local sales taxes in the state
    - A single tax return.
    - One uniform sales tax base in the state used by state and local governments.
    - Require "destination-based" tax collection for online sales (that is, collect taxes based on the delivery location, or if that's not available, the address associated with the payment instrument, or if that's not available, the seller's location).
    - Provide software that identifies the applicable tax rate for a sale, including local rates, and hold sellers harmless for any software errors or mistakes by the state
    - Provide 30 days notice of any local sales tax rate change, or forgive sellers that don't adjust tax rates for changes made with less advance notice.
- Remote sellers are exempt from collection obligations if they have less than $500,00 per year in sales in the United States. The limit applies to related firms, preventing subdivision to get under the limit.
- States can collect taxes unless their state supreme court or the U.S. Supreme Court finds them out of compliance with the act.
- Explicitly does not address franchise, income, occupation, or other taxes.

The main sponsor is Sen. Mike Enzi (R-WY), and co-sponsors are Sens. Dick Durbin (D-IL), Lamar Alexander (R-TN), Tim Johnson (D-SD), John Boozman (R-AR), Jack Reed (D-RI), Roy Blunt (R-MO), Sheldon Whitehouse (D-RI), Bob Corker (R-TN), and Mark Pryor (D-AR).

Amazon.com has responded favorably to the bill, although other retailers are concerned that the $500,000 threshold is too low. The National Conference of State Legislatures (NCSL) issued a supportive letter instantaneous with the introduction.

## Conclusion

Businesses throughout our nation's history have plied their trade across state lines. Today, with new technologies, even the smallest businesses can sell their products and services in all fifty states through the Internet and through the mail. If such sales can now expose these businesses to tax compliance and liability risks in states where they merely have customers, they will be less likely to expand their reach into those states.

Unless a single nexus standard is established, the conflicting standards will impede the desire and the ability of businesses to expand, which harms the nation's economic growth potential.

We here at the Tax Foundation track the numerous rates, bases, exemptions, credits, adjustments, phaseouts, exclusions, and deductions that litter our federal and state tax codes. Frequent and ambiguous alterations of tax codes and the confusion they cause are a key source of the growing tax compliance burden. We have several staffers as well as computer-based and publication subscriptions dedicated to being up to date and accurate on the frequent changes to the many taxes in our country, but even we have trouble doing it. It would be extremely difficult for retailers who are in business to sell a good or service, not to conduct tax policy research.

Under either physical presence or economic nexus, brick-and-mortar stores need to worry only about the tax system where they are physically present. The same would be the case for online retailers under a physical presence standard. But under an economic nexus standard, out-of-state and online businesses would have to collect and comply with sales taxes based on where their *customers* are located. This would burden e-commerce more than brick-and-mortar business, and effectively impose an exit toll on outbound commerce. Effective state simplification must be a part of any national solution.

The Internet has seen an increased amount of commerce, but many state officials seem to view it as a golden goose that can be squeezed without adverse effects on economic growth. It must be understood that the availability of many items in electronic commerce could be hindered if states are permitted to simply extend their sales taxes to online commerce without serious simplification that establishes a level playing field for all types of businesses and reduces costs and burdens to interstate commerce.

Congress can obtain evidence from interested stakeholders and take political and economic factors into consideration when developing new rules of taxation. The Supreme Court, by contrast, must develop broad doctrine in a case-by-case fashion, based on the facts of the particular case before them. (Additionally, the Court seems to have an aversion to tax cases.) This is why congressional action, which can be more comprehensive and accountable than judicial action, and can better address issues of transition, retroactivity, and *de minimis* exemptions, may now be the best vehicle for preventing burdens to interstate commerce by adopting a uniform physical presence standard. It is up to Congress to exercise its power to protect interstate commerce.

We now live in a world of iPods, telecommuting, and Amazon.com. It is a testament to the Framers that their warnings about states' incentives to hinder the national economy remain true today.

Some may argue that faster roads and powerful computers mean that states should now be able to tax everything everywhere. While some constitutional principles surely must be revisited to be applied to new circumstances, the idea that parochial state interests should not be permitted to burden interstate commerce remains a timeless principle regardless of how sophisticated technology may become.

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ABOUT THE TAX FOUNDATION

The Tax Foundation is a non-partisan, non-profit research institution founded in 1937 to educate taxpayers on tax policy. Based in Washington, D.C., our economic and policy analysis is guided by the principles of sound tax policy: simplicity, neutrality, transparency, and stability. We seek to make information about government finance more understandable, such as with our annual calculation of "Tax Freedom Day," the day of the year when taxpayers have earned enough to pay for the nation's tax burden and begin earning for themselves.

ABOUT THE CENTER FOR LEGAL REFORM AT THE TAX FOUNDATION

The Tax Foundation's Center for Legal Reform educates the legal community and the general public about economics and principled tax policy. Our research efforts focus on the scope of taxing authority, the definition of tax, economic incidence, and taxpayer protections.

Performance Marketing Association, Inc.

# Why Congress Needs to Enact Federal Sales Tax Legislation: The Devastating Impact of State-by-State "Affiliate Nexus Tax" Laws on 70,000 Small Businesses

By Rebecca Madigan
Executive Director, Performance Marketing Association

**US House of Representatives Judiciary Committee Hearing on:** Constitutional Limitations on States' Authority to Collect Sales Taxes in E-Commerce

December 4, 2011

Mr. Chairman and Members of the Committee:

A critical element has been lost in the debate surrounding proposed Internet sales tax legislation: state-by-state piecemeal attempts have *already* devastated 70,000 small online-based businesses, yielded states $0 in new sales tax revenue and, in fact, reduced income tax revenue. A federal solution will lay to rest these desperate and futile attempts states pursue to solve their budget shortfalls.

Over the past three years, 8* states have passed 'Affiliate Nexus Tax' laws, unconstitutional attempts to compel out-of-state retailers to collect their sales tax. These Affiliate Nexus Tax (aka 'Amazon tax') laws claim out-of-state retailers have 'nexus' or physical presence, if they advertise on websites owned by businesses (known as 'Affiliate Marketers') in states where these laws have passed, thereby requiring them to collect sales tax.

These laws have been failures to the states and the impact on Affiliate Marketers has been catastrophic: out-of-state retailers simply sever their advertising agreements with Affiliate Marketers in order to avoid collecting sales tax. These affiliate marketing businesses lose a devastating portion of their income, causing them to move out-of-state, lay off employees, or shut their doors.

## Real Devastation to Small Businesses

- 70,000 affiliate businesses in 8 states have been devastated by the passage of Affiliate Nexus Taxes.
- On average, these businesses lose **25% - 35%** of their income when these laws pass. *Imagine what losing a third of your income would mean to you.*
- An estimated 800-900 online retailers terminate their advertising agreements when these state laws pass.

- In California, where there were 25,000 affiliate businesses, **35% lost over half their incomes when the law passed there**. And 32% moved out of state.
- States don't gain any new sales tax revenue, and lose income tax revenue – especially when these businesses move out-of-state and take all their income with them.

Performance marketing was a $17 billion industry in 2010, the fastest growing type of advertising and one of the fastest growing technology sectors. *This industry is made up of entrepreneurs, is growing and creating a lot of jobs, except in states where the affiliate nexus tax passed.*

State-by-State Impact

Below is detail about each state where an Affiliate Nexus Tax law passed: the number of Affiliate Marketers in the states before the laws passed, their earnings and contributing state income tax revenue:

**New York**
Affiliate Nexus Tax passed in 2008
- 15,000 affiliate marketers
- In 2007, they earned $746 million and paid an estimated $51 million in state income tax

**North Carolina**
Affiliate Nexus Tax passed in 2009
- 6,000 affiliate marketers
- In 2008, they earned $416 million and paid an estimated $32 million in state income tax

**Rhode Island**
Affiliate Nexus Tax passed in 2009
- 800 affiliate marketers
- In 2008, they earned $57 million and paid an estimated $4 million in state income tax

**Illinois**
Affiliate Nexus Tax passed in 2011
- 9,500 affiliate marketers
- In 2010, they earned $744 million and paid an estimated $22 million in state income tax

**Connecticut**
Affiliate Nexus Tax passed in 2011
- 3,000 affiliate marketers
- In 2010, they earned $236 million and paid an estimated $7 million in state income tax

**Arkansas**
Affiliate Nexus Tax passed in 2011
- 2,000 affiliate marketers
- In 2010, they earned $157 million and paid an estimated $11 million in state income tax

**California**
Affiliate Nexus Tax passed in 2011
- 25,000 affiliate marketers
- In 2010, they earned $1.9 billion and paid an estimated $152 million in state income tax

**Pennsylvania**
Affiliate Nexus Tax announced (reinterpreting existing statute) December 1, 2011*

- 9,000 affiliate marketers
- In 2010, they earned $700 million and paid an estimated $22 million in state income tax

Congress Can Help

Congress has the power to change current sales tax law, and on behalf of the 200,000 small businesses we represent, Affiliate Marketers, we ask the Committee to recommend legislation that will allow states to collect sales tax from out-of-state retailers, without the nexus requirement. Without the nexus requirement, the Affiliate Nexus Tax laws are moot; out-of-state retailers can reinstate their in-state advertising partnerships.

The PMA supports H.R.3179 because it includes the 'No Nexus' concept, which preserves Federalism and states' unique sales tax policies – and allows Affiliate Marketers to get back in business!

* On December 1, 2011, one day after the House Judiciary Committee met to discuss Federal Internet tax policy, Pennsylvania issued a press release announcing that its Department of Revenue has reinterpreted existing statute to declare an Affiliate Nexus Tax is now in place. As a result, out-of-state retailers immediately began terminating advertising agreements with Pennsylvania-based Affiliate Marketers.

In Conclusion

The PMA and our industry made up of over 200,000 small businesses nationwide, urge Committee members to recommend H.R.3179.

*The Performance Marketing Association (PMA) is a not-for-profit trade association founded in 2008 to connect, inform and advocate on behalf of performance marketing, a multi-billion-dollar marketing channel, which comprises more than 200,000 businesses and individuals. Continued growth of the performance marketing space is expected as advertisers, facing small budgets and big expectations, increasingly look to performance-based marketing initiatives to expand their business. Additional information is available at:*
*http://www.performancemarketingassociation.com*

December 7, 2011

**Re: Unions Support Legislation to Enable State & Local Governments to Collect Sales Tax from Online & Remote Sellers (Streamlined Sales Tax)**

Dear Representative:

The undersigned labor unions strongly support legislative proposals that enable state and local governments to collect sales tax from remote and online sellers of goods and services.

For many years we have advocated for closing the loopholes that allow sellers to avoid collecting sales tax on these purchases made via mail, telephone, and the internet. This is especially important now because lost tax revenues are increasingly harmful to state and local government budgets while providing an increasingly unfair competitive disadvantage to Main Street and mom-and-pop retailers. According to BNA Daily Tax Report, "as much as $23 billion in revenues for the year 2012 will go uncollected".

Now is the time to enact legislation to achieve these goals. Congress has clear constitutional authority to take action to regulate interstate commerce of online and remote sales. There is also clear support from state and local governments for congressional action. Support for and participation in the development of Streamlined Sales and Use Tax Agreement (SSUTA) demonstrates that effective and efficient solutions are available. Furthermore, the argument that requiring small businesses to collect sales and use tax would be too burdensome is not convincing. Most experts now agree that accurate and affordable sales tax collection software currently exists to enable relatively effortless collection of existing state and local sales taxes.

It is important to note that Congress would not be enacting any new taxes. These taxes already exist under current law in 45 states and the District of Columbia. Hundreds of millions of U.S. consumers either unknowingly or purposely are not paying their fair share of use taxes on tens of billions of dollars of remote and online purchases. In contrast, Congress, through enactment of congressional legislation, would simply be providing state and local government the authority and ability to collect the existing taxes that are owed

In these challenging economic times, Congress must ensure that state and local governments can collect owed tax revenues and all businesses face a level playing field with consumers. Ideally, Congress would enact legislation that both preserves the taxing authority of state and local governments and grants them the legal authority to collect taxes already owed on remote and online sales. For these reasons, we support the "Main Street Fairness Act" (H.R. 2701/S. 1452) and the "Marketplace Fairness Act" (S. 1832). These bills generally address existing problems and offer constructive solutions.

We look forward to working with Congress to enact legislation to address this issue.

Sincerely,

**American Federation of Labor and Congress of Industrial Labor Organizations (AFL-CIO)**
**American Federation of State, County and Municipal Employees (AFSCME)**
**American Federation of Teachers (AFT)**
**Department for Professional Employees, AFL-CIO**
**International Association of Fire Fighters (IAFF)**
**International Federation of Professional and Technical Engineers (IFPTE)**
**International Union, UAW**
**National Education Association (NEA)**

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