

## The NetChoice Coalition

*Promoting Convenience, Choice, and Commerce on The Net*

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May 17, 2011

Representative Kerry A. Benninghoff  
House Finance Committee  
Pennsylvania State Legislature  
Harrisburg, PA 17120-0001

Dear Chairman Benninghoff and Members of the Committee:

Thank you for accepting this statement on behalf of NetChoice, a coalition of trade associations and e-Commerce businesses who share the goal of promoting convenience, choice, and commerce on the Net.

Now is a critical point in the evolution of e-commerce, online services, and social media. Online companies are experimenting with new ways to deliver products, services, and content, and business of all kinds are going online to reach consumers and advertise to receptive audiences. At the same time, state governments are looking online for additional revenue.

We fully understand the need for states to seek out additional tax revenue. However, we worry that legislation designed to force collection of taxes by out-of-state online retailers could bring costs and unintended consequences on Pennsylvania businesses and consumers.

At the outset, we encourage your consideration of greater goals as you weigh revenue options. We believe that there are three key considerations to guide you:

1. Keep Pennsylvania competitive in economic development and job creation;
2. Avoid additional tax burdens on Pennsylvania residents; and
3. Reduce barriers to the competition, convenience, and choice offered by e-commerce.

While many forms of taxation are within a state's legal prerogative, questions of tax policy come down to *what should be taxed* and *how should those taxes be collected*. We suggest applying the above principles when considering Pennsylvania's taxation of Internet activity:

1. Should Pennsylvania make significant efforts to collect from remote retailers, when taxes on most e-retail sales are already being collected?
2. Should Pennsylvania embrace the Streamlined Sales Tax Agreement?
3. Should Pennsylvania attempt to impose tax collection burdens on retailers who spend advertising dollars on Pennsylvania businesses?
4. Should Pennsylvania attempt to impose a likely unconstitutional Use Tax reporting requirement on out-of-state businesses?

## **1. Should Pennsylvania make significant efforts to collect from remote retailers, when taxes on most e-retail sales are already being collected?**

A common misconception is that consumers shop online to avoid paying sales tax. In reality, Pennsylvania consumers buy online for convenience, selection, and lower prices. In fact, 17 of the top 20 online retailers already collect sales tax for Pennsylvania.

A growing share of online purchases by Pennsylvania taxpayers are from larger retailers who operate both retail stores and websites, where online sales result in tax collection, not tax avoidance. So any obligations imposed on out-of-state retailers will fall hardest on small businesses that go online to find customers around the country in their effort to compete with big-box retailers.

## **2. Should Pennsylvania embrace the Streamlined Sales Tax Agreement?**

Advocates of Streamlined Sales Tax (SST) typically complain that *'it's not fair that online retailers don't pay taxes.'* But it's just not true. Just like brick-and-mortar stores, online retailers collect sales tax for any sale they make in every state where they have a physical presence.

For example, Harvest Book Company has a store on 'Main Street' in Fort Washington, Pennsylvania. They have seven full-time employees and sell their books across the country. Harvest collects Pennsylvania sales tax on every sale they make in Pennsylvania today but not in states where Harvest has no physical presence. They are typical of many 'Main Street' retailers who realize that the Internet is their best way to compete with big-box stores and reach customers across the country and around the world.

So is the complaint about fairness unfounded? No. Pennsylvania retailers rightly say that out-of-state catalog and web retailers have an advantage since they don't have to collect sales tax on shipments to Pennsylvania customers. However, business purchasers rarely avoid sales tax since nearly all Pennsylvania businesses file and remit use tax to the state on any item where the sellers did not collect sales tax. Also, individual consumers who avoid Pennsylvania sales tax by buying from out-of-state sellers may find their unpaid sales tax is offset by shipping costs, delivery time, and the inconvenience of doing returns and exchanges via UPS or the Post Office.

As you consider ways to collect unpaid sales and use taxes, bear in mind why remote retailers don't collect Pennsylvania's sales taxes. Whether online or offline, out-of-state retailers have never been required to collect remote state sales taxes because the Supreme Court ruled that the complexity of 7,500 taxing jurisdictions – with different rates and rules – is an undue burden on interstate commerce.<sup>1</sup>

SST member states have always known that they could go back to the Supreme Court and attempt to show that they have truly eliminated the unreasonable burdens on interstate commerce. Instead, SST states are asking Congress to grant them the power to impose their collection burdens on out-of-state businesses—whether or not the burdens are reasonable.

Despite a decade of effort, the actual simplification achieved by SST is not nearly enough to convince Congress that it should abandon its role in protecting interstate commerce. Instead, the SST has shown that simplification is now merely a slogan – not a standard. The SST Governing Board has repeatedly amended the Agreement to make it easier for states to conform—without significantly making their sales tax systems any simpler. While this may seem to make SST more attractive to Pennsylvania, Congress will not grant SST states the authority to collect from remote sellers without first attaching minimum simplification requirements that go beyond what's in the present SST Agreement.

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<sup>1</sup> *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

For instance, one key simplification requirement in federal SST legislation is “uniform sourcing.” Until last year, SST required that member states source all sales to the destination where goods are received. That requirement was seen as a significant barrier for an “origin state” like Pennsylvania, which lets localities impose their own add-on sales tax for sales that originate from their jurisdictions.

To help states like Pennsylvania join the SST, the Governing Board amended its Agreement to let states use ‘dual sourcing’ - origin-based for in-state sales, but destination-based for sales from out-of-state. But if Congress holds to a common-sense definition of “uniform sourcing,” the SST Agreement will not meet the test for true simplification. And that means states would have to switch to destination sourcing to take advantage of remote collection mandates authorized by Congress. The revenue dislocation effects of that change would be a significant detraction from the benefits Pennsylvania might realize by joining SST.

Even if Pennsylvania decides to stay out of the SST, Congress may decide to mandate collection for states that do join SST. And if Congress passes the mandate, sellers everywhere would be forced to collect remote taxes – even sellers in states that haven’t joined the Agreement.

Moreover, Congress may pass an SST collection mandate that’s not so simple for the many Pennsylvania businesses that sell to customers in other states. With a federal mandate in place, Pennsylvania has no way to protect its businesses from a national tax system that’s not simple, lacks a small-business exception, and fails to compensate sellers for new collection costs.

The uncertainties regarding sourcing and other federal requirements argue strongly for Pennsylvania to stay on the sidelines of SST. If Congress mandates collection, Pennsylvania can then make a fully informed decision whether to become an SST member state.

### **3. Should Pennsylvania attempt to impose tax collection burdens on any retailer who spends advertising dollars with Pennsylvania businesses?**

Pennsylvania should avoid the failed method of treating online advertising as a basis to force out-of-state companies to collect sales tax for the Commonwealth. State laws that use Internet advertising as a proxy for an in-state sales representative have unintended problems and unrealized revenue projections.

In New York, the legislature passed a law designed to increase sales tax revenue from remote e-retailers. The law applies to companies that use an extended network of websites for displaying online ads. The law changes the presumption of what it means to be “soliciting business” in the state, and creates a rebuttable presumption of nexus when an out-of-state company advertises through New York websites.

The law is particularly tenuous because Internet sales pose a unique set of administrative challenges for nexus determination. Sellers generally cannot determine whether affiliates are legal residents of a particular state. Generally, sellers do not control the affiliate websites, and can’t determine whether a specific ad is a direct or indirect solicitation for business. Moreover, websites aren’t location specific.

The taxation of Internet sales also raises constitutional questions. For instance, in reaction to concerns of being overly broad, New York issued a technical bulletin making a distinction between a “commission” on sales and a “set fee” on clicks. And an agreement to compensate a NY website for a click-through that results in a completed sale falls under the presumption.

Moreover, a New York state court further narrowed the law by proposing a safe harbor that Amazon (and other online retailers) can use to rebut the presumption of active solicitation. The court, in dicta, stated that

“Out-of-state sellers can shield themselves from a tax collection obligation by altogether prohibiting in-state solicitation activities referring to them or encouraging sales on their behalf that would subject them to a tax collection requirement and, as a condition of compensation, requiring that their NY contractors attest to compliance.”<sup>2</sup>

Remarkably, despite two attempts to clarify the law, it still remains an open question as to what constitutes “active solicitation” or “encouraging sales.” As a consequence, retailers will either avoid advertising in New York, or contort their advertising practices so they can avoid jurisdiction in New York.

Beyond tax policy, these laws have the detrimental effect of enshrining non-commission ads as the preferred form of online advertising. This has the effect of letting tax law dictate how to advertise online without incurring tax collection burdens, at the exclusion of all other potentially superior methods of advertising. Nobody wins if we settle for inefficient advertising that generates fewer ad dollars for in-state publishers and websites.

The net effect is a lot of pain with little gain. It is important to note that there isn't any new money flowing into the states under this plan. Some advocates imply that new taxes would come from out-of-state retailers, but in reality these tax dollars are coming from the pockets of state residents -- at a time when household wallets are being squeezed in a struggling economy.

Other states are already reconsidering similar laws. For example, Rhode Island, through H 5115, is actively working to repeal its version of this law after advertisers simply cancelled their affiliate programs. Retailers like Amazon and Overstock can discontinue their affiliate programs in states where these laws are enacted. This costs the states hundreds of jobs without producing any additional tax revenue.

We would therefore caution Pennsylvania against following this aggressive and constitutionally dubious approach and to refrain from imposing tax collection burdens on retailers that spend their advertising dollars with publishers and businesses based in Pennsylvania.

#### **4. Should Pennsylvania attempt to impose a likely unconstitutional Use Tax reporting requirement on out-of-state businesses?**

A reporting requirement requires out-of-state sellers to describe the types of purchases made by citizens to the Department of Revenue and/or to the citizen's home state as part of year-end tax reporting. But passage of such legislation exposes Pennsylvanians to potential invasions of privacy and possible constitutional violations.

A requirement for out-of-state sellers to report to the Pennsylvania Department of Revenue the resident's name, date of sale, and/or dollar amount of each sale would tell the Department from whom a citizen buys their products and services, revealing highly personal and sensitive activities. For example, if a citizen bought products from a pharmaceutical distributor, the Department would learn of that citizen's medical or psychiatric condition.

Also, any requirement for a seller to engage in purchaser reporting disproportionately harms small sellers by forcing them to mail notice letters to every purchaser.

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<sup>2</sup> *Amazon.com LLC v. New York State Dept. of Taxation and Finance*, 877 N.Y.S.2d 842 (N.Y. Sup. 2009).

An out-of-state reporting law could lead Pennsylvania into the same unconstitutional area as Colorado's HB 10-1193. A Colorado judge recently enjoined such legislation, stating:

"looking to the practical effect of the Act and the Regulations, I conclude that the burdens imposed by the Act and the Regulations are inextricably related in kind and purpose to the burdens condemned [by the US Supreme Court] in Quill."<sup>3</sup>

If Pennsylvania follows Colorado, it could find itself in court arguing the constitutionality of its law. And when a state loses these court battles, it must pay the opposing party's attorney's fees as well as any legal costs the state incurs. Pennsylvania should defer consideration of out-of-state reporting requirements until it is certain not to generate expensive legal costs for Pennsylvania.

**Pennsylvania must consider its actions before enacting legislation.**

We appreciate your decision to take a careful and considered approach to enacting new tax legislation. This can be a difficult process, and if not done properly can result in unintended consequences to Pennsylvania consumers and businesses – without generating the anticipated tax revenue.

We thank you for considering our views. Please let me know if I can provide further information for your deliberations on these important issues.

Sincerely,



Steve DelBianco  
Executive Director, NetChoice  
cc: Members of the Committee

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<sup>3</sup> *The Direct Marketing Ass'n v. Roxy Huber*, No. IO-CV-01546-REB-CBS (June 30, 2010).