Statement of

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Hearing on: HR 3179, the "Marketplace Equity Act of 2011"

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Chairman Smith, Ranking Member Conyers, and members of the committee: thank you for holding this hearing on HR 3179 and the "internet tax" debate. My name is Steve DelBianco, and I serve as Executive Director of NetChoice, a coalition of leading e-commerce and online companies promoting the value, convenience, and choice of Internet business models. NetChoice members include industry leaders such as eBay, Expedia, Facebook, LivingSocial, NewsCorp, Overstock, VeriSign, and Yahoo, plus several thousand small businesses that go online to reach their customers.

NetChoice has been deeply engaged on Internet tax issues for over a decade, including recent media debates in the Wall Street Journal and on CNBC, Marketplace radio, CNN, and PBS. Since 2004, we have participated in meetings of the Streamlined Sales Tax Project (SSTP), a long-term effort that HR 3179 seeks to sweep aside.

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

In this testimony we are discussing legislation that would authorize states to impose sales tax obligations on out-of-state businesses (HR 3179). Our major points are:

1. For businesses without stores or distribution centers in multiple states, HR 3179 would allow states to <u>impose a new tax</u> with uniquely complex burdens of nearly 10,000 tax jurisdictions in 46 states.
2. HR 3179 <u>does not require nearly enough sales tax simplification</u> to justify imposing significant new burdens on out-of-state businesses.
3. The new tax burdens imposed by HR 3179 are <u>not justified by anticipated revenue</u>, since total potential sales tax on all consumer e-commerce is well below one percent of total state & local tax revenue.
4. HR 3179 <u>does not adequately protect America's small businesses</u>, for whom new collection burdens would be disproportionately complex and expensive.

The House Judiciary committee is ideally positioned to deliberate whether to expand state taxing powers to include out-of-state businesses and citizens.   To help with that deliberation, we begin with some straight answers to critical questions.

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

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

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

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

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

In 1992, the Supreme Court took another look at tax collection by an office products catalog company by the name of Quill.[3] Seeing a patchwork of rates and rules for several thousand sales tax jurisdictions,

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

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

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

the Court again held that requiring out-of-state companies to collect and remit taxes was so complicated that it presented an unreasonable burden on interstate commerce.

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

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

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

Would HR 3179 create a new tax?

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

For example, Michigan "sales tax" is actually a tax on the privilege of doing business in the state:

> … there shall be collected from all persons engaged in the business of making sales at retail, by which ownership of tangible personal property is transferred for consideration, **an annual tax**

[4] *See Quill Corp. v. North Dakota,* 504 U.S. 298 at 313 FN 6 (1992).
[5] *Id.* at 312 (emphasis added).

> **for the privilege of engaging in that business** equal to 6% of the gross proceeds of the business, plus the penalty and interest if applicable …[6]

As in all state sales tax statutes, the Michigan sales tax is the personal liability of the seller. The seller is allowed, but not obligated, to pass the tax along to the consumer. Today, only businesses that have presence in Michigan are required to pay a tax for the privilege of engaging in business there. HR 3179 would enable Michigan to impose its "privilege" tax on businesses with no facilities, no vote, and no voice in Michigan. The fact that the tax can be passed on to Michigan consumers does not make it any less a *new tax burden* for businesses all over the country.

Arizona and California use the same approach, imposing their sales tax for the "privilege" of selling goods to state residents, even if shipped via common carriers:

> "The Arizona transaction privilege tax is commonly referred to as a sales tax; however, the tax is on the privilege of doing business in Arizona and is not a true sales tax. Although the transaction privilege tax is usually passed on to the consumer, it is actually a tax on the vendor." [7]
>
> California: "The sales tax portion of any sales and use tax ordinance adopted under this part shall be imposed for the privilege of selling tangible personal property at retail" [8]

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

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

The Supreme Court's *Quill* decision also made it clear that states could simplify their sales tax systems and come back to the Supreme Court and show that they have truly eliminated the unreasonable burden on interstate commerce.

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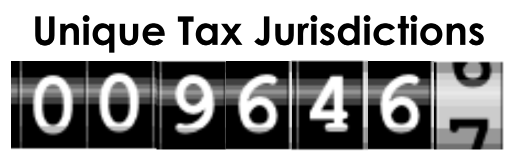
[6] Michigan Compiled Laws Of 1979, Chapter 205 Taxation, General Sales Tax Act, § 205.52]

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

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

But instead, a handful of states chose to skip the harsh judgment of the Court and go directly to Congress to request the power to impose these burdens on out-of-state businesses. Their efforts began a decade ago with the Streamlined Sales Tax Project (SSTP).

Despite a decade of concerted effort, the actual simplifications achieved by the SSTP are not nearly sufficient to justify Congress abandoning its role in protecting interstate commerce. Rather, the SSTP has shown that *simplification has become just a slogan – not a standard*.



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

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

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

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

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

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

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

> Start with the US Department of Commerce's *2010 Electronic Commerce Industry Assessment,* which reported total retail e-commerce of $169 billion.[10]
>
> Apply an average tax rate of 7 percent, giving total potential sales tax of $11.8 billion.
>
> Divide that by total state and local tax revenue in 2010, reported as $1.3 trillion by the Commerce Department. [11]

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

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

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

They concluded that uncollected sales tax on e-commerce in 2010 was $4.2 billion nationwide, or *less than one-third of one percent of total state and local tax revenue*.[12] This relatively small incremental revenue does not justify a dramatic expansion of state taxing powers and new collection burdens on remote businesses.

[10] US Census Bureau E-Stats, http://www.census.gov/econ/estats/2010/2010reportfinal.pdf

[11] US Census Bureau E-Stats, http://www2.census.gov/govs/qtax/2011/q2t1.pdf

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

Isn't there increased momentum to overturn Quill?

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

Big-box retail chains are pushing hard for federal legislation for a simple and predictable reason: it serves *their* interests. Even a little simplification helps a big-box retailer who must already collect tax for most states, as seen in this list. Big-box retailers now have expansive web-stores of their own and give customers the convenience of doing pickups and returns at their local stores. These chains use plenty of local public services wherever they have stores, so they must collect sales tax in all their states – as required under current law. The Eisenach study looked at sales collection practices for the top 500 e-retailers, and found that 17 of the top 20 already collect in at least 38 of the 46 sales tax states.

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

Why would Amazon.com support overturning Quill?

Big-box retailers have aggressively gone after Amazon in the states, lobbying for new "Amazon Tax" laws declaring that Amazon already has physical presence by virtue of its advertising affiliates, distribution centers, or other subsidiaries in the state. The big-box retailers also lobbied for a new tax reporting law in Colorado, which was enjoined by a federal court as a violation of the Commerce Clause.[13] Despite the setback in Colorado and pending court challenges of the "Amazon Tax" in New York and Illinois, this aggressive and expensive state lobbying campaign has succeeded in creating well-publicized tax compliance problems for Amazon. Those problems have helped to drive Amazon to support federal legislation to overturn *Quill*.

But there's another reason for Amazon's about-face: the company is changing its business model by adding distribution centers in new states to enable faster delivery to customers. Amazon is also adding

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

drop-boxes in convenience stores and marketing daily deals to local merchants. As a result, Amazon will have physical presence in 14 states by 2014[14] – requiring Amazon to collect sales tax *for more than half of all Americans*. And as Amazon opens more distribution centers across the country they will continue to increase their tax collection requirements.

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

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

Is this debate really about "fairness"?

The Constitution's Commerce clause is not about ensuring fairness. As explained above, it was all about preventing unreasonable barriers to interstate commerce, such as the customs duties imposed by the independent states before they united. In fact, *Quill* explicitly dismissed the fairness argument, saying the "Commerce Clause and its nexus requirement are informed not so much by concerns about fairness" but rather "the effects of state regulation on the national economy."[15]

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

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

[14] By 2014 Amazon will collect and remit sales taxes in the following states California, Indiana, Kansas, Kentucky, North Dakota, New York, Pennsylvania, South Carolina, Tennessee, Virginia, and Vermont.

[15] *Quill*, 504 U.S. at 312.

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

And *there's actually little evidence that retailers who do collect sales tax are losing significant sales to catalog and online retailers who collect sales tax only for their home state customers.*

That makes sense, since sales tax and shipping costs aren't added until a consumer's online shopping cart goes to checkout. So comparison shoppers are usually comparing prices *before* adding any tax and shipping charges. Moreover, online shoppers usually pay shipping and handling charges that offset any tax that's not collected on most commodities. Most shoppers go online for the convenience and selection availability, not to avoid taxes. And while small and expensive electronics are a notable exception, tax proponents have shown no data indicating that significant numbers of electronics shoppers deliberately choose out-of-state online retailers just so they can avoid paying sales tax.

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

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

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

For decades, "main street" retailers have been getting battered by Walmart and other national chains. To survive, many main street retailers have gone online with their own web stores or with e-commerce platforms to serve repeat customers and to find new customers across the country. For example, the specialty retailer SilverGallery.com has a warehouse and store—located on Main Street—in Waynesboro, Virginia. SilverGallery, which was featured in a Wall Street Journal article last year, does some walk-in trade, but most sales come from their web store and other online channels.[16] Online sales growth enabled SilverGallery to buy their building and increase employment, right there on Main Street.

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

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

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

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

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

[16] *See* Angus Liten, *Sales-Tax Measures 'to Cost Us Big',* Wall. St. Jo. (Dec. 1, 2011).
[17] *Available at* http://www.netchoice.org/wp-content/uploads/cost-of-collection-study-sstp.pdf.

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

With that understanding of what small online businesses would face from overturning *Quill*, it's easy to see why House Judiciary Committee members Coble, Griffin, Lundgren, Lofgren, Marino, and Sensenbrenner co-sponsored a resolution to protect our nation's Internet entrepreneurs from new tax collection burdens. H. Res. 95 is titled "Supporting the Preservation of Internet Entrepreneurs and Small Businesses," and its main point is this simple pledge:

> Congress should not enact any legislation that would grant State governments the authority to impose *any new burdensome or unfair tax collecting requirements on small online businesses* and entrepreneurs, which would ultimately hurt the economy and consumers in the United States.[18]

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

HR 3179 is not an improvement on Quill's physical presence standard.

The actual simplification required in HR 3179 is not nearly sufficient to convince Congress that it should abandon its Constitutional role in protecting interstate commerce.

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

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[18] H. Res. 95, 112th Cong. (2011) (emphasis added).

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

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

HR 3179 does not include adequate protection for small businesses

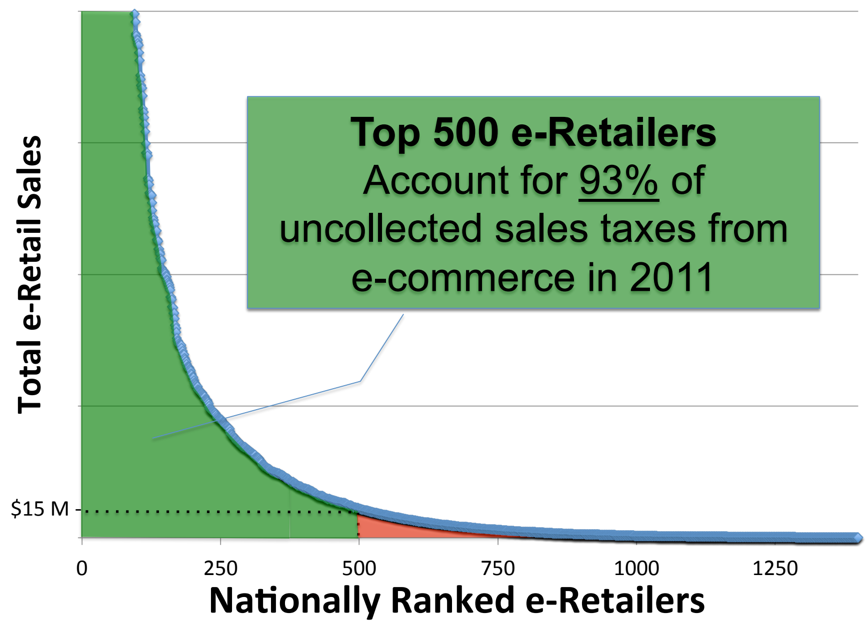
HR 3179 includes a small seller exception that is appropriately mandated by Congress, as opposed to other legislation that leaves it to state tax administrators to set the exception level. But HR 3179 sets the exception threshold at just $1 million in annual remote sales, a number that is far too low for retailers, whose entire expense and payroll must be paid from the margin on sales:

- $1 million in gross sales times 25% average gross margin leaves just $250,000 to cover all costs of running the entire business.
- Those costs include advertising, rent, supplies, insurance, shipping, computers and programming, website, accounting, communications, travel, etc.
- If there's anything left after paying those costs, this business *might* be able to pay an employee or two.

Make no mistake about it -- $1 million in retail sales is still just a "mom and pop" operation. The Small Business Administration says a "small" retailer is one with annual sales 20 to 30 times larger than the threshold in HR 3179. The small business tax bill recently passed by the house set a small business threshold at 500 employees, whereas only a few employees could be carried by a retailer with just $1 million in sales.

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

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



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

HR 3179 fails to require true tax simplification or reduce administrative burdens

Congress should require robust minimum simplifications before overturning the *Quill* standard of physical presence for states to impose sales tax on remote businesses. Previous Congressional legislation to overturn *Quill* included as many as 16 minimum simplification requirements that SSTP states would have to honor. But HR 3179 requires only 3 measures and they lack essential provisions:

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

Minimum Simplification Requirements lacking in HR 3179:

- Remote retailers should not be subject to audits from 46 separate state tax authorities. States should respect the outcome of a single audit by any state, on behalf of all states.
- Remote retailers should be allowed to use a single sales tax rate for remote sales made into each state, which was the original goal of the SSTP. State lawmakers would, of course, be able to allocate sales tax proceeds among local jurisdictions.
- States should be required to adopt a single set of definitions for taxable and exempt products across all states. HR 3179 allows each state to have its own unique definitions:

  "products and services subject to tax must be identical throughout the state"
- States should compensate all businesses for the fair and reasonable cost of collecting sales taxes, taking into account such elements as credit card fees and costs of software implementation and maintenance. Compensation was required in previous federal legislation to overturn the *Quill* physical presence standard, but was dropped in recent versions.
- Remote businesses should not be required to file sales tax returns for all 46 states. All states should accept a single sales tax return filed with a business' home state. The home state revenue department would be responsible for distributing funds to remote states.
- Remote retailers should not be required to honor, but may observe, caps and thresholds for sales tax calculation. (an example of a threshold is Massachusetts, where the first $175 of any clothing item is exempt from sales tax[21])
- Remote retailers should not be required to honor state-specific sales tax holidays.
- States should be required to adopt a single rule for sourcing sales. The SSTP originally maintained destination sourcing for all sales tax transactions. But to accommodate origin-based states, SSTP's Governing Board voted to allow origin sourcing for in-state sales while requiring destination sourcing for remote sales. Such "dual sourcing" should not be permitted as part of any federal legislation overturning the physical presence standard.
- States must provide certified software for collection, filing, and remittance. Users of the software would be immune from civil liability for errors in taxes collected. HR 3179 requires software and liability protection only for states that demand remote businesses collect at the local destination rates.

These minimum simplifications should be required for any state that seeks collection authority outside of Quill's physical presence standard, whether as part of HR 3179 or in legislation authorizing collection by SSTP member states.

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

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

HR 3179 fails to hold states accountable to simplification requirements

If Congress grants states the authority to impose sales tax on remote sellers, there must be a mechanism to hold states accountable to the minimum simplification requirements above. HR 3179 subjects states to "a court of competent jurisdiction" to determine whether the state meets minimum requirements. But under the Tax Injunction Act (28 USC §1341), taxpayers are forced to use *state* courts to litigate disputes with state tax collection authorities, even on questions of whether a state is following federal law. It would be far better if federal courts had sole jurisdiction over disputes arising between states and remote businesses regarding a state's compliance with federal law.

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

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

HR 3179 would impose collection burdens on businesses in *all 50 states* – including those in states that don't even have a sales tax. Lawmakers in all 50 states would lose the sovereign right to protect their citizens and businesses from tax burdens imposed by other states.

If these new collection burdens are hurting businesses in a state, their legislators won't be able to rescue those businesses if Congress makes collection mandatory for all. This comes as a surprise to many lawmakers who are just beginning to understand the implications of legislation such as HR 3179.

Contrast the national mandate in HR 3179 with a multi-state compact, where states could opt-in if they believed new tax revenues justified having their in-state business collect taxes for other states in the compact. By the same token, states could *opt-out* of the compact if remote state tax burdens were excessive. States opting-out would lose the power to force remote sellers to pay their sales tax, but at least states could protect their own businesses from unreasonable burdens on interstate commerce.

Conclusion

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