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THE INTERNET SALES TAX: HEADACHES AHEAD FOR SMALL BUSINESS?

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BEFORE THE

SUBCOMMITTEE ON REGULATORY REFORM AND OVERSIGHT

OF THE

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

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WEDNESDAY, FEBRUARY 8, 2006

HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON REGULATORY REFORM AND OVERSIGHT
COMMITTEE ON SMALL BUSINESS
Washington, DC

The Subcommittee met, pursuant to call, at 10:00 a.m., in Room 2360 Rayburn House Office Building, Hon. W. Todd Akin [Chairman of the Subcommittee] presiding.

Members present: Representatives Akin, Sodrel, Kelly, Bordallo, and Christensen.

Mr. AKIN. The committee will come to order. I am Congressman Todd Akin. We will proceed as I make an opening statement. There will also be a couple of other opening statements, one by the Ranking Member Ms. Bordallo. She is due here any minute. And also from Congresswoman Kelly, also very interested in this topic. After that what I would like to do is to proceed through all of our witnesses.

I think it is better for us who are in Congress, the different staffers that are here as well, I think we get a better picture by just running through all of your testimony. Then you can submit written statements if you would like. What I would like to do is in order of time, keep you to somewhere in the five minutes range? I just want to hit the highlights of what you want to say in five minutes.

When we get done going through all the witnesses we will come back with specific questions. Different members here will ask you questions based on comments that you made but maybe comments that someone else made and want to just cross check with you. Typically I have a pretty good record of being able to get things done in an hour.

Today this may be a hot enough topic that we may want to run a little bit more than that but I would think maybe at the most an hour and a half we should be able to wrap things up. You will see these little lights. There is a little light in front of you. When it gets red that means your five minutes is up. I don't usually throw these things but still we want to keep things moving.

Good morning and welcome to today's hearing entitled "The Internet Sales Tax: Headaches Ahead for Small Business?" I want to especially thank those witnesses who have traveled to partici-

pate in today's hearing, particularly all the way from Washington State.

The Internet has emerged as an extremely important channel of commerce in our nation. For this reason, we must be vigilant in keeping this medium as unencumbered from regulations and taxes as possible. I am skeptical of anything that constitutes a new tax or imposes new onerous regulations on our nation's businesses, especially those selling over the Internet.

We are here to investigate recent federal and state efforts to shift responsibility to collect state sales and use taxes to out-of-state Internet vendors. A state currently can not impose that burden unless a business has a constitutionally significant presence or "substantial nexus" within the state. Because e-commerce has become a vital channel for businesses of all sizes, many states are concerned with the loss of potential tax revenue.

Consequently, these states have banded together to form the Streamline Sales and Use Tax Agreement, which is an effort to harmonize sales and use tax laws and simplify tax collection for vendors. Member states of this agreement argue that by creating a more uniform system of laws in this nation and easing burdens on vendors, they in turn should be given the authority by Congress to collect sales and use taxes from out-of-state Internet vendors.

Currently, two nearly identical bills have been introduced in the Senate that would provide such authority to states. Both measures include an exception from remote sales and use tax collection for small businesses. However, the bills differ in how this should be accomplished. Thus far, no companion legislation has been introduced in the House.

Today our panelists will address the many issues surrounding implementation of the Streamline Sales and Use Tax Agreement. Particular emphasis will be placed on the scope of the current federal legislation and the many new compliance burdens that could be placed on our nation's businesses if this legislation is enacted.

I look forward to the testimony from our witnesses today. I now yield for an opening statement from the gentlelady from Guam. If she is not here, we will proceed to a second opening statement. I want to explain if it wasn't previously clear that this is the Small Business Committee and one of the things that we are jealous to do is to guard small businesses from unnecessary red tape and regulations because we are big believers that small businesses are the engine of the future growth of our country. Certainly that is the angle that we are looking at this issue from is the Small Business Committee. That is why we are having the hearing in the first place.

Now I would recognize the gentlelady from New York State, Ms. Kelly.

[Chairman Akin's opening statement may be found in the appendix.]

Ms. KELLY. Thank you very much, Mr. Chairman. I represent New York's Hudson River Valley where small businesses simply can't bear additional burdens, especially as they relate to taxes. The existing moratorium that affects state and local taxation of Internet transactions should be handled in a way that certainly does not have a negative impact on these small businesses.

We cannot forget that we are dealing with small businesses that have limited resources in terms of employment and finances which also means limited capabilities. When the Government puts unnecessary and unreasonable strains on such, those small businesses will be forced to close. There is no doubt that having to collect and remit taxes for states other than the state where the small business resides would be an extreme burden. It is not just collecting and remitting.

Specifically, these taxes involve tracking closely where the items are purchased as well as the tax code of that state to be certain that the proper tax is collected. Further, the paperwork would prove to be a nightmare for these small businesses and it would be expensive. It is a burden that many small businesses simply cannot meet. Companies would be forced to limit sales outside the state they are in.

No business should be held to such limitations simply because the tax requirements are insurmountable. I am hopeful that through discussions such as this today and in the future that we can develop a solution that does not hurt the people who are involved. Most importantly we must work to eliminate existing tax burdens on our small businesses and not create new ones.

I thank all of our panel here today. I look forward to your testimony and I appreciate the sensitivity that you have to this issue. Thank you for being here.

Mr. AKIN. Thank you, Congresswoman. Appreciate your perspective and your care and interest in small business as well.

Also now from our ranking member, Ms. Bordallo, opening statement, please.

Ms. BORDALLO. Thank you very much, Mr. Chairman. Greetings to all of the witnesses here. I apologize for being a few minutes late.

I want to thank you, Mr. Chairman, for holding this hearing to review the application of a sales tax to Internet commerce and the affect that this would have on the vitality of American small businesses. I look forward to hearing the testimony today.

I represent Guam, way out there in the Pacific. Internet based commerce is particularly important to my constituents. The advent of the Internet and the massive growth of the e-commerce sector have certainly opened up a wealth of opportunity for business owners and consumers on Guam and across the country.

On site such as Amazon.com, eBay and countless others have allowed sellers and buyers and it has made it easier for the purchasing of goods and services at the competitive price. Internet based commerce has had a notable positive impact on the U.S. economy that has resulted in tens of thousands of new highly-skilled and high-paying jobs. Expectations are that the Internet commerce industry will continue to grow in the coming years.

For example, retail e-commerce sales projected to top $80 billion for fiscal year 2005 which is up from $69.2 billion in on-line retail sales generated in fiscal year 2004. Many small businesses will contribute to and benefit from this growth. The Internet allows them to expand their markets at marginal additional cost allowing them to compete more fairly with their larger counterparts.

However, the uncertainty of the sales tax treatment of goods sold over the Internet is a major obstacle for many small businesses entering into Internet based commerce. In particular, the collection and remittance of taxes on Internet commerce is a complex and costly problem from small businesses to solve.

Currently, on-line buyers are taxed according to where the item they purchased will be delivered as opposed to where the vendor is located. The opposite is the case with traditional over-the-counter sales in traditional businesses. A buyer, for instance, from Guam who makes a purchase from a store in Virginia will pay Virginia sales tax.

Because the tax law varies from state to state and among U.S. territories, small businesses, many of which only have a few employees, face difficulty in comply with the complexity of these various tax codes and a barrage of federal regulations that they need to follow.

Although the Internet may be able to quickly connect you to every community across the U.S. knowing the particulars for the roughly 7,500 distinct tax jurisdictions in the United States, is quite a daunting task even for the most talented of entrepreneurs. The application of a sales tax to Internet commerce would appear to be a potential to curb the further growth of this unique sector of the American economy.

Today's hearing, gentlemen, will provide us with an opportunity to hear more about this issue in an effort to better understand the potential impact of tax collections on small on-line retailers. I am particularly interested in hearing more on how these changes will impact the future development of our nation's 23 million small businesses many of which have already tried their hand at Internet sales. Thank you very much, Mr. Chairman.

[Ranking Member Bordallo's opening statement may be found in the appendix.]

Mr. AKIN. Thank you for that opening statement. With that we are going to just proceed pretty much down the line here with our witnesses. Our first is a distinguished professor of law at the University of Georgia, Walter Hellerstein. Did I get that right?

Mr. HELLERSTEIN. That's good enough.

Mr. AKIN. Pretty close? And I note you are a graduate of Harvard and the University of Chicago Law School. Look, we've only got five minutes but we are going to try to be good students and go back to class here and try and pick your brain for five minutes of highlights. Thank you. Proceed, please.

STATEMENT OF MR. HELLERSTEIN, UNIVERSITY OF GEORGIA

Mr. HELLERSTEIN. Thank you very much, Mr. Chairman. I really appreciate your invitation and the opportunity to address this Subcommittee. I want to just try to do two things in my oral testimony. One, briefly —

Mr. AKIN. Is your mic on or is it aimed at you in anyway?

Mr. HELLERSTEIN. First of all, I want to thank you very much for inviting me. I want to focus just on two points in the oral testimony. One, to try to give you a broad overview of what the law is, the law of Internet sales taxation. Second, to try to focus on what

policy choices you have should you decide to change the law in any way that you deem appropriate.

First of all, what is the law? Every state that started to have a sales tax had this problem. The problem was if someone went to a jurisdiction that didn't have a sales tax, they would lose revenue. Their business would lose revenue. So they couldn't impose a sales tax. Washington can't impose a sales tax on a sale that takes place in Oregon which doesn't have a sales tax. What do they do? They impose something called a use tax. What is a use tax? A use tax is the same thing as the sales tax but it is within the state's jurisdiction because it is imposed on the use of property in the state.

I will give you an example. I come from Georgia. Say I go to Oregon to buy a car. Do I pay a sales tax? No. Why not? Oregon doesn't impose a sales tax. I bring my car back to Georgia. What happens? I go to register my car and I pay a use tax equal to the sales tax that I would have paid had I bought the car in Georgia.

Okay. Now, I buy a book from Amazon.com. Do I pay sales tax? No. Why not? The sale takes place in Washington or wherever their fulfillment facility is. I bring the book back to Georgia. Very simple. I go to the book registry. Right? There is no book registry. As long as we have a first amendment there probably won't be a book registry. I owe the use tax but I'm not going to be the first person in the history of Georgia voluntarily to remit a use tax. Now you see the problem.

The tax is due, I'm not going to voluntarily remit it, and there is no jurisdiction over Amazon to require Amazon to collect the tax in the same way that a Wal-Mart or a local vendor would collect the tax. Why not? For the very reasons that you have already alluded to. There are so many different state tax laws and so many different states and counties that the U.S. Supreme Court said, "It is so complicated we're not going to require the out-of-state vendor to collect the tax unless there is a physical presence."

There you have it very briefly. There is power to tax the stuff that I am bringing into Georgia wherever I buy it. There is no power to require the out-of-state vendor to collect it and, therefore, these taxes that are legally due don't get collected.

Now, what do you do about this? If you like the law the way it is, you leave it. You do nothing but maybe you don't and here it seems to me there is a question of what you might think about in terms of your choices. First of all, I think one policy choice not before you is whether or not something that I buy over the Internet is taxable. It is taxable.

Every state, the 45 of the 50 states that have sales taxes say, "We want to tax stuff that you buy in other states that don't have sales taxes." I don't think that should be on your plate. What is on your plate is whether or not it's right to require a small mom and pop business to collect. I think you might want to look at these questions in deciding whether the law is appropriate as it is or should be fixed.

What are the costs of collecting sales and use tax under this new regime? What are the additional revenues collected under the proposed regime? What is the relationship between nationwide gross sales and these costs? What is the relationship between costs in a particular state and cost of collection and revenues? What is the re-

lationship between having a separate legal entity and cost collection?

I think in the end you have to decide on the basis of facts that I don't have personally but you will hear from other witnesses what is the appropriate line to draw? Right now we have a physical presence test. Does that make sense? Does it make sense if we are concerned about small business, for example? A small business sends one sales person into a state and they have physical presence.

They have to collect a huge multi-million dollar retailer that maybe has sophisticated software and a staff of tax people. Maybe it is appropriate for them to collect. I don't know but I think one thing you have to ask is what test makes sense, if any? Maybe you want to say nobody who sells over the Internet should ever have to collect a tax because that makes sense. All I'm telling you, or urging you to focus on, is the policy issues associated with the collection of taxes and the revenues of the states that derive from it. With that I see the yellow light is on. I will end my testimony.

[Mr. Hellerstein's testimony may be found in the appendix.]

Mr. AKIN. You have redeemed about 30 seconds of your time. That is admirable and a great way to start a hearing. Thank you very much for coming in and we'll get back with some questions.

Our next witness is Brian—is it Bieron?

Mr. BIERON. Bieron.

Mr. AKIN. Bieron. And you are the Senior Director of Federal Government Relations with eBay?

Mr. BIERON. Yes, sir.

Mr. AKIN. And hailing from Washington, D.C. right here. Is that right, Brian?

Mr. BIERON. Well, before I started in Buffalo, New York. I'm originally from Buffalo, not from here.

Mr. AKIN. Thank you, Brian. Please proceed.

STATEMENT OF MR. BIERON, EBAY, INC.

Mr. BIERON. Mr. Chairman, thank you, and thank you to the members of the Subcommittee. I would like to thank the Committee for giving eBay this opportunity. We agree that this is a critically important issue to small business entrepreneurs who increasingly use the Internet to compete in the 21st century economy.

One of the most important developments on the eBay market place is that hundreds of thousands of small businesses from across America have discovered that eBay is a vibrant place to do business. Currently over 700,000 of our nation's small business people are using eBay as a valuable marketing channel. We believe that nearly a half million of these began their business off of eBay, in many cases in brick and mortar stores.

They are using the Internet as a new way to compete and grow. Increasingly main street and the Internet are not competing with each other so much as main street small businesses are using the Internet to compete and survive against global retail companies. That creates small business jobs in communities all across the nation. The stated goal of the Streamline Sales Tax Project is to increase state revenues.

Before I talk about the SSTP process itself, I wanted to mention a few points related to the overall economic environment that we think are important in this debate. One is that the U.S. economy is strong and growing and small business entrepreneurs and innovators using Internet technologies in many cases are one of the most important engines of growth in job creation.

No. 2 is that state tax revenues including sales tax revenues are up at record levels. There simply is no state revenue crisis. Three, off-line and on-line retail are both growing and in terms of actual dollars of retail sales, off-line retail actually grew $65 billion more than on-line retail in the last quarter that we have data.

Please keep in mind that off-line retail is still 97 percent of total retail sales. The SSTP is supposed to deliver real simplification and true sales tax simplification would have real merit but we believe that the SSTP is a long way from true simplification.

Complying with the sales tax regimes in every state tax jurisdiction is about more than just calculating how much sales tax is required for each product sold. Although with over 7,600 different tax jurisdictions, just calculating is a major job in itself. Complying with the SSTP would require four distinct phases, calculation and collection of the money, remittance to the proper jurisdiction, and all the record keeping because you can be audited every year.

I am afraid that it is not possible to do justice to the SSTP in just five minutes but I think it is revealing that both into the entire SSTP scheme is the clear understanding that small businesses cannot comply on their own ever. The SSTP is designed to required small businesses to be associated with technology firms, Certified Service Providers, or CSPs for short, that will need to do the job for them.

I believe that it is really a critical point for every one here to walk away with. The SSTP supporters admit that their system won't work unless outside technology companies are involved. If small businesses can't or don't use an outside technology, then under the SSTP they basically need to get off the Internet. While states claim that they will pay those providers, the amount promised is likely to prove very insufficient and would put small businesses at the mercy of a very unreliable system

With this in mind and with over 700,000 Americans using the eBay market place to help run their small businesses, we believe that a workable and robust exemption for small business is an indispensable component of any Internet sales tax plan.

SSTP legislation in recent Congress has included a small business exemption in name, often called an SBE, but the substance fell short of the mark. The level of the SBE was arbitrary and far below established federal small business side standards for retailers. This deficiency still plagues S.2152, the recently introduced Enzi bill.

Senator Byron Dorgan, a long-time advocate of the SSTP, recently introduced S.2153 with a small business exemption process that eBay believes would protect small businesses. It would empower the Small Business Administration to establish the SBE-size standard in process. They are the federal agency with the mission to help promote America small business and entrepreneurs and the experience to do this job right.

On behalf of the hundreds of thousands of small businesses using eBay today and the countless small business entrepreneurs that we are confident will be empowered by the Internet in the coming years, we are committed to working with Congress and this Committee, as well as the SBA to ensure that this process is done right. Thank you and I am happy to answer any questions.

[Mr. Bieron's testimony may be found in the appendix.]

Mr. AKIN. Thank you, Brian. I appreciate your bringing it in on time also. Our next witness is Paul—is it Misener?

Mr. MISENER. Yes, sir.

Mr. AKIN. And you are with Amazon?

Mr. MISENER. That is correct.

Mr. AKIN. So we have got both eBay and Amazon side by side agreeing on every point or maybe not.

Mr. MISENER. Usually. Usually.

Mr. AKIN. Proceed, please, Paul.

STATEMENT BY MR. MISENER, AMAZON.COM

Mr. MISENER. Thank you, sir. Thank you for inviting me to testify as well. I appreciate that.

Mr. Chairman, the Internet is a great enabler of small business. In it's early days the Internet was a haven for innovative technically savvy small businesses. Today it has become an important channel for all kinds of small retail businesses, not just those with technical expertise. Less we forget, a decade ago Amazon.com, eBay, Yahoo, and other current household names were observe small businesses with something in common.

Technical skills that enabled them to provide content-based services useful to nontechnical people. These small business owners overcame the technical challenges of putting up and running a website, tracking consumer traffic to the site, and with the help of electronic payment processors facilitating retail transactions.

At the time none of this was easy but as these small businesses grew into the big businesses they are today, they have actually simplified the task of getting a small retail business on-line. Indeed, these companies and others now provide services so that today's small businesses don't have to be technically savvy to make good use of the Internet.

There are several different e-commerce business models now coexisting and vigorously competing on the web. One model of platform retail where large companies such as Amazon.com and eBay and Microsoft's MSN provide e-commerce services to other companies both large and small.

My friends at eBay deserve particular credit for their success with the platform model. eBay sells marketing, inventory management, sales tracking, reporting, and other services to small businesses and annually has tens of billions of dollars of sales transactions running through their website.

The first public policy question presented by these circumstances is whether the states should be authorized to require remote sellers to collect tax. By conserving fuel, saving time, and using fewer public roads and other local services, e-commerce arguably should remain under taxed. Amazon.com does not have a position on this high-level policy question. We concluded almost six years ago, how-

ever, that Amazon would not be hurt by a sales tax collection requirement so long as the administration burden of collection were eliminated in that our on-line competitors also would collect.

The second key question for policy makers is have the states adequately simplified their tax codes. Although Amazon believes that even more simplifications could and should be made, we think the current Senate bills if applied fairly would require adequate simplification, at least for sellers on line or using other electronic transaction services.

This brings us to the third and last key question. Is there any justification for requiring only some classes of sellers to collect but not others? It has been suggested, for example, that small out-of-state businesses be given a blanket exemption from tax collection requirements. At Amazon.com we are not particularly familiar with transactions involving paper money or substitutes like personal checks or traveler's checks. There may be good reasons to exempt truly small interstate sellers using such instruments.

But we are very familiar with electronic payment systems, especially those operating on-line. With these systems, transactions are processed by a relatively small number of very large companies that can and will provide tax collection services if they are required directly or by law or by market forces.

To be sure, no one expects truly small businesses to do the work of sales tax collection alone but that doesn't mean they shouldn't be required to do it at all. By analogy we require small business persons to sign their legal documents in ink but we don't expect them to make their own ballpoint pens.

Amazon.com will offer sales tax collection services to our small seller customers. I am sure that our on-line competitors also can and will. Of course, this discussion so far as been limited to small businesses conducting interstate sales. What about small main street businesses selling locally? Even after a decade of e-commerce, as Brian has pointed out, still over 90 percent of retail sales are off line.

Small main street businesses already collect sales tax and, thus, have both the administrative burden of tax collection and the higher prices caused by it. If out of state small businesses would not have to collect, then their main street brethren would be saddled with a competitive disadvantage both as to burden and price. Hopefully policy makers never would conclude that this disparity would be fair to main street small businesses.

In conclusion, Mr. Chairman, the Internet is a great enabler of small business and if Congress eventually decides to allow states to require out of state sellers to collect sales tax, large companies will provide the necessary tax collection services to small businesses and cure the preexisting disadvantages to small businesses off-line.

Thank you again for inviting me to testify. Of course, I look forward to your questions.

[Mr. Misener's testimony may be found in the appendix.]

Mr. AKIN. Thank you very much, Paul. Appreciate your coming in and we will get back to you with some questions in a minute.

Ernest Perry. You are actually one of the people we are talking about. You are the owner of a small business from, I believe, Charlotte, North Carolina. Is that correct?

Mr. PERRY. That is correct.

Mr. AKIN. Please proceed, Ernest.

STATEMENT OF MR. PERRY, PERRY'S AT SOUTHPARK

Mr. PERRY. Mr. Chairman and members of the Subcommittee, my name is Ernest Perry and I have been a small business owner in North Carolina for more than 25 years. I started in the jewelry business in 1978, managing a store for the retail chain Jewel Box Stores Corporation in Greensboro and learned as much as possible about running a business and the jewelry industry.

Always wanting to go into business for myself, I had also become a licensed auctioneer and began offering my services to non-profits where I helped sell donated estate and antique jewelry to raise funds for their organizations. I later opened my own store called Perry's Jewelry Emporium, specializing in antique and estate jewelry in 1980.

In 2002 I got my business on-line. As I was undergoing a remodeling project for the store, a woman who was helping me with the remodeling introduced me to eBay. She talked about the ease of conducting business on eBay and of the many success stories and I was immediately interested. While my storefront was continuing to do well, I was intrigued about having an on-line presence for my jewelry collection and being able to reach a much broader customer base. It was then that I recognized eBay's marketing potential and I developed the concept for Treasures Recycled.

Along with the overstocked items from my store, I began to accommodate the growing number of people turning to me to handle the resale of their personal jewelry. People bring me the items they would like me to sell for them and I turn to eBay to get the job done. This approach has allowed me to sell items to people in every state and many, many countries.My sales from my eBay business continue to increase each year, approximately generating $1 million in annual sales. With just the on-line store, I have five employees and offer full benefits.

While some people claim that there are big technology companies that would be happy to step in and take care of the tax collection and remittance job, I think that the SSTP process is filled with risk for small business owners. There are significant potential costs that I can see for any complicated sales tax plan, especially when a small business is forced to contract the job out to one of a handful of technology companies.

Computer system upgrades or changes, training employees on new systems, and the possibility that the off-the-shelf solution doesn't work right, are all expensive risks. And finally, what if a couple of years down the road the fees go up? There is no going back and small businesses will be the losers.

There is no question that it has not been easy to be a small business retailer over the last few decades. The world has changed so much. The Internet is obviously one big change, and it's been both a challenge and an opportunity in the retail business.

I understand the tax issues and the "fairness" question raised by on-line businesses that do not collect and remit sales tax for sales to out-of-state customers. Be assured I do collect and remit taxes for Perry's according to the tax code in North Carolina. There is single sales tax rate and a single tax authority to remit the taxes to.

Legally I am not required to collect and remit sales taxes for all the customers outside of North Carolina who visit Treasures Recycled, my on line presence. There is really no doubt in my mind regarding the complexity of what would be required to collect and remit taxes on the thousands of different tax jurisdictions around the country. My understanding is that there are more than 7,600 jurisdictions nationwide. There would undoubtedly be new costs imposed on my on-line business that would be very hard, if not impossible, to deal with as a small business owner.

But small retailers have also had to adapt and adjust to mega-retailers like Wal-Mart and the Big Box Stores who have used all kinds of technologies to revolutionize their global retail businesses. And in my experience, the Internet has actually empowered small business people to deal with those dramatic changes.

I believe there is no question that the Internet offers a small business more opportunity than risk. And I believe that Congress changing the status quo on state sales tax laws would make it harder in the long-term for small businesses and entrepreneurs to succeed in the face of those challenges.

Again, thank you for inviting me to speak to this Committee today.

[Mr. Perry's testimony may be found in the appendix.]

Mr. AKIN. Ernest, thank you for your testimony. That is really the heart of what this Committee is about is to take a look at small business and make sure that we are not going in some direction that is going to hurt our small businesses. Thank you very much for sharing with us.

Our last witness, Rory Rawlings. I believe that you are one of the people that has taken a look at this complexity and kind of dared to step into that nexus of red tape and everything and actually try to provide a service. Is that correct?

Mr. RAWLINGS. That is correct.

Mr. AKIN. To try and sort this out and make it simple for small business. Rory Rawlings, you are the Founder and Chief Tax Automation Officer of Avalara is it?

Mr. RAWLINGS. Yes.

Mr. AKIN. In Seattle.

Mr. RAWLINGS. Yes.

Mr. AKIN. You get the award for coming the farthest today. We really thank you for making the travel for us. Thanks, Rory. Go ahead.

STATEMENT OF MR. RAWLINGS, AVALARA, INC.

Mr. RAWLINGS. Thank you, Mr. Chairman. I believe that we really have two competing interests that we are dealing with. First of all, we've got the state and local jurisdictions. I live on Bainbridge Island. It is a suburb of Seattle separated by eight miles of water. On Bainbridge Island we vote periodically on whether or not we

should levy new taxes for the city of Bainbridge Island. Those taxes are for various different local services, services that are needed by our city.

Those services vary from transient taxes to police services to needed local services. The real question is when people on Bainbridge Island or people in any local jurisdiction purchase goods on the Internet or purchase goods anywhere from out of state should they really be required to pay those sales taxes. So that is on one side.

On the other side we have got small businesses. We work with small businesses day in and day out. Out whole mission is to serve small businesses and make sales tax less taxing. I believe that small businesses are the key to continued growth and prosperity for our nation. I believe that red tape is a very bad thing for small businesses. The administrative burden on the current tax law is very high. So how do we reconcile those two issues?

Well, we reconcile those two issues with Sales Tax Management Services. Sales Tax Management Services, or STMS, is really the result of the convergence of various technologies and public policy. If you take a look at the tax industry over the years, it really began as information services or information subscriptions from companies like CCH and RIA, data subscriptions, statute, research, that sort of things.

Then it evolved into sales tax software, sales tax software that was very large, very complex to implement, and very expensive to purchase. Sales tax software that was applicable to very large businesses and fulfilled the needs of very large businesses.

Now with the Internet technologies, with security technologies, with spacial and geographic information systems we can take the software that was built and provided to large businesses and put it into a service environment. Just as main street merchants sell goods across the Internet as well as their brick and mortar store, we can now offer the Sales Tax Compliance Services across the Internet.

With STMS, or Sales Tax Management Services, we can provide at very low cost these full compliance services. Not only can we accurately validate, correct, and standardize the address which then feeds into the jurisdiction assignment but at a street level we can determine what the boundaries are. We can determine what the product taxability is, customer exemptions, as well as automatically generate those returns, automatically do the remittance for any size business.

Whether that is a small business or a large business we can do this at a very affordable price. The reason we can do it at a very affordable price is because we are not selling software. It is a service. It is very similar to a cell phone plan. With a small up front fee and a monthly fee based on transaction volume, Avalara sells a service today as well as other companies. This service starts in the case of Avalara at $29.99 a month. So with this service we can resolve the competing interest of both the local jurisdictions who have passed the taxes who really are owed the taxes.

These taxes have been on the books for many years and have not been collected. As well as eliminate the burden on small business. I believe that the real issue is not whether or not we should ex-

empt small business from taxes or whether or not we should not provide the taxes owed to local jurisdictions. It really is a matter of resolving both of these two competing interests through the use of technology.

[Mr. Rawlings' testimony may be found in the appendix.]

Mr. AKIN. Thank you for completing your testimony. It is interesting. All of you have had fascinating questions, potential questions anyway, that are quite interesting. Obviously from a political point of view there are a whole series of different questions involved here.

Some of them are fairly complicated in the sense that they are touching so many different jurisdictions. Then there is the overall question about taxes themselves. As the Chairman I guess I have the opportunity to start with some questions. Maybe I'll start, Walter, with you. I'll just say what will happen if Congress does nothing and the states try to relitigate the Quill decision?

Mr. HELLERSTEIN. That is a very good question. I think a question frankly that no one really knows the answer to. What it will depend on is whether or not the court, which in the past has said things are so complex for the remote or out-of-state vendor that we can't require them to collect without imposing a burden on commerce and, therefore, they can't be required to collect.

The question is have things gotten simple enough that that burden doesn't exist anymore? Honestly, Mr. Chairman, I don't think we know the answer to that question. If you ask me, I suppose right now would I take on a contingency a case that was going to relitigate Quill no I wouldn't.

If Streamlined were enacted, obviously in the absence of congressional blessing, and every state or 35 out of the 45 states joined, and there was additional evidence of administrative simplification, maybe my answer to that would change. I think it is a very good question and the key to the answer is to what extent have the states actually simplified to remove the underlying premise of Quill which is that life is too complicated.

Mr. AKIN. Then just a follow-up question. Should Congress enact legislation that enable the collection of taxes on remote sales?

Mr. HELLERSTEIN. If Congress can satisfy itself that it has provided sufficient standards to simplify the life of the small business person. I think presumably with some reasonable threshold. I think it is important to have a threshold, a reasonable threshold that makes sense, whether it is based on 100 pounds of flesh in the state or $200 million of sales in the state, I don't know.

I think you need to have evidence on that issue but I would very much encourage you to do that because I think that way you have a fair collection of revenues without putting a burden on small business. And you satisfied yourself that the simplification is sufficient but I think those are the questions you need to look at very carefully. What is sufficient simplification and what is the appropriate standard for exempting small business.

Mr. AKIN. I guess part of what I was asking and maybe to venture into a little bit of a policy question, is it possible that this non-tax part of commerce is something that actually is very positive and will drive the economy. Maybe by exempting it in a sense we

are just allowing something to go on which is good for the economy overall. I guess I was getting a little bit at that.

Mr. HELLERSTEIN. Again, my answer is that that is an important policy point but I guess I would say assuming that is correct, it is important to have a rational standard for exemption. I am not sure that 100 pounds of flesh is a rational standard.

Mr. AKIN. My co-Chair here.

Ms. BORDALLO. Thank you very much, Mr. Chair. I have just one question, I guess, for each one of them but I will go back to you, Mr. Chairman. The first is for Dr. Hellerstein. Is that correct?

Mr. HELLERSTEIN. Some people call me Dr. I think doctors give injections. Walter is just fine.

Ms. BORDALLO. Walter is fine. All right. It is understandable that local communities wish to collect taxes from the sale of goods over the Internet just as they tax the sale of goods over the counter. Local communities stand to generate a significant amount of revenue by doing so. However, in your opinion would a tax on Internet sales prevent small firms from doing business on the Internet?

Mr. HELLERSTEIN. I think, Representative, the answer to that question is really what you have already talked about and what other witnesses have spoken about which is the extent to which that burden would impose cost on the small business. I think that at some point if the marginal cost of collecting tax is greater than the marginal revenue of the sale, they will no longer do that. That is a factual question. I don't know the answer to it but I think I know how I would go about inquiring.

Ms. BORDALLO. Thank you. Then I have one for Brian Bieron. Is that correct?

Mr. BIERON. Yes, ma'am.

Ms. BORDALLO. If sellers on eBay were required to collect sales taxes in as many as 7,500 taxing jurisdictions, would you expect to see some of eBay's sellers close their businesses?

Mr. BIERON. Well, we have been told by many of them that they think that it would be a significant burden. As Mr. Hellerstein said, it would raise their cost. It would make it far more complicated to do business. In many cases we think it would dissuade them from starting down the path. In a lot of ways eBay is a market place that is very friendly to small business so small businesses come and start doing some business over our market place.

As I said, we have about 500,000 of the small businesses that are using the market place now. They didn't start there. They weren't born on eBay but they were small businesses who came to it to get at a global market really. We think that it would create a new complicated burden where let's say you have a storefront somewhere and you are competing with the Wal-Marts of the world. You think that the Internet is a new place to start to get some marginal sales. If part of that first hurdle was to have to take on this whole burden, we think that would stop a number of the small businesses from trying that avenue.

Ms. BORDALLO. Thank you. I have a couple more questions, Mr. Chairman.

Mr. AKIN. Go for one more.

Ms. BORDALLO. All right. Okay. This is for Ernest Perry. If your business were to be charged with collecting sales taxes from cus-

tomers from out of state, what impact would this have on your bottom line and what kinds of human and technical resources would you need to fulfill this particular requirement?

Also, it seems to me that if you are required to collect sales taxes on Internet sales to out-of-state customers, this could be an expensive proposition for you that might require you to raise prices on items in your storefront. Is this possible?

Mr. PERRY. You are exactly right and I am glad you asked that question. I was just sitting here thinking listening to these comments that I am paying taxes now in the state of North Carolina and I was just thinking about how much paperwork that it takes that I have to keep for like five years. It would be the equivalent of this table just to keep the North Carolina sales tax. Can you imagine if I had to keep tax records for 50 different states, although it would be maybe simplified.

Then I have got to worry about maybe being audited by any or all of those 50 states at any given time of the year. It would be a nightmare and I just don't think that it would be—I think it would discourage a lot of Internet sellers, especially the small mom and pop that are working out of their garage or out of their bedrooms even to just throw their hands up and not even try. It would be impossible.

I mean, there is no way they can keep up with the paperwork they would have to keep up with. Also the worry about the audits that they may have to worry about. I am sure the technology companies can do it but we have to pay these guys to do this and we don't know if it is going to work or not. We will still be the ones that would saddle the burden for all of that.

Ms. BORDALLO. Thank you.

Mr. AKIN. I just think I will continue along the same line of questioning just to make things fair here.

Rory, you have got the company that has got all this stuff programmed. You must be a very patient fellow to have programmed all of these different jurisdictional laws into a computer, or else you have hired some very patient people. I wanted to give you a chance to respond to the other comments.

Mr. RAWLINGS. Sure. I appreciate that opportunity. When it really comes down to the burden on small business, small businesses are currently burdened. Small businesses currently pay sales tax. Small businesses currently spend a lot of money paying sales tax. Sales tax compliance is very difficult. It is very complicated. It is very confusing.

Even with a single taxing jurisdiction you have got to deal with product exemptions. You have got to deal with entity based exemptions. You have got to deal with filling out the forms. Many of these small business owners don't know how to fill out these forms. They are making guesses.

The real solution, or I believe the real solution, is solved in technology with the convergence of Internet technologies, security technologies, and geo-spacial technologies we can accurately determine what those taxes are. We can take those tax transactions and the history of those tax transactions and store it in a secure database behind multiple firewalls. We can use the power of the Internet, the same Internet that we are talking about.

Mr. AKIN. If I could jump in, are you saying that you would then as a service provide all the record keeping that was necessary for a small business?

Mr. RAWLINGS. Absolutely. That is what we do today and that is what we have been doing for the past three years.

Mr. AKIN. Go ahead and proceed.

Mr. RAWLINGS. So we maintain those tax transactions. We automatically generate those tax returns through a web browser interface. Here again the power of the Internet. The small business owner opens up their web browser, logs on through a secure log on, and views their tax return, prints out all of their historical transactions. All that information is available for an audit. Under Streamline it even gets simpler.

I do believe there are opportunities under Streamline to make the taxes even simpler. Really from a technology standpoint it doesn't make a difference. All of those rules are coded into the software. The software will be, and is in the process of being certified by the states. The security and the reliability is being certified by the states.

We have gone through months of audits and months of review and months of working with the states submitting multiple test decks and verifying that we can generate it in an electronic return and verify that we can, in fact, collect the taxes, that we can, in fact, remit those taxes to the states. We have gone through many, many hours of review.

From my perspective, it is not a matter of increasing the burden on small business. It is a matter of providing a service that is affordable. Now, whether that is paid for by the state or paid for by the small business, frankly we have got 2,200 users from the beginning of 2005 so our business is growing 200 percent quarter over quarter.

We have got a very big need to fill with or without sales tax, with or without a change in policy. Our belief and our experience is that small businesses are burdened today with the collecting and complying with sales tax in their local jurisdiction. Here, again, we have 2,200 users. We are growing at 200 percent quarter over quarter rate.

We charge a lot of our customers $29 a month for a complete compliance solution. Does it make sense to exempt small businesses? That really is a policy question. Avalara does not want to get involved in policy but I believe it is a timing issue. You know, it is a matter of adoption. We may want to as a nation exempt small businesses to begin with and then start dropping the exemption over time. Whatever makes sense for the country but I can tell you this. I can tell you that there are technology solutions available, that there are very easy almost zero burden tax compliance solutions available. In my mind it doesn't make sense to use that as an excuse to exempt—

Mr. AKIN. I hear what you are saying. If there is a mistake made, who is liable? Let us say that something isn't calculated the right way and the small business guy says, "Hey, wait a minute. You did something wrong." Is it your company or is it the small business guy that has to pick up the tab legally if something isn't done right?

Mr. RAWLINGS. Under Streamline I am liable. For anyone who uses my system I am liable. If I make a mistake, I have to pay the difference.

Mr. AKIN. And not the small business guy? Okay. Thank you.

Next question, Ms. Bordallo.

Ms. BORDALLO. Thank you, Mr. Chairman. I have just one other question and I think it is along the same lines of your question. I don't want a dollar figure but how much would a comprehensive software package cost to small business? Do you feel it would be reasonable? Is it affordable? Do you have different types of packages for them to engage in such as just the basics or full service? Also in line, you said your firm has conducted audits. Have they always been successful?

Mr. RAWLINGS. First of all, the types of services that we do provide. We have various levels of service. We have a basic plan. We have a full product tax ability, what we call AvaTax Pro. Then we have a full breadth of services so we have a full service offering which is nearly zero burden as far as the business is concerned. The costs do start at $29.95 cents a month.

Ms. BORDALLO. That is the basic package?

Mr. RAWLINGS. Yes.

Ms. BORDALLO. Your audits.

Mr. RAWLINGS. Oh, the audits. Here again, we have 2,200 users and none of those users have ever had an issue with the tax audit. We have had numerous clients that have gone through multi-year audits with California and virtually every state in the country. Not once have we had anyone of those clients come back and say, "Hey, you guys really screwed up and we are having trouble."

Ms. BORDALLO. Having trouble, yeah. All right. Thank you, Mr. Chairman. That concludes my questions.

Mr. AKIN. Thank you.

This is a general question. Usually now sales tax is collected at the original of where a sale is made is my understanding. What we will be talking about here would be a destination type of sales tax. Does that make things more complicated or how do you see that influencing things? Walter, if you want to start.

Mr. HELLERSTEIN. Mr. Chairman, I really don't think it is appropriate to say that the sales tax is tax at origin. The sales tax is a destination tax. It is a consumption tax. In fact, for example, if a Georgia vendor sells to an out-of-state purchaser, there is no tax. When we buy over the counter, origin and destination happen to be the same. In the end a consumption tax, which a sales tax generally is, is normally imposed at the destination. That is exactly why Georgia will impose a use tax on me when I go to Oregon to buy a car.

In fact, if a Washington dealer could ship a car out of Washington, the title not passing, they wouldn't impose a tax. Nobody wants to impose a tax on exports. So really we have a destination based sales tax in this country except when we have destination and origin that in the particular transaction are at the same point.

Mr. AKIN. So you are saying in a way that is a false distinction. You are saying everything is destination. Is that what you are saying?

Mr. HELLERSTEIN. What I am saying is that, in general, sales tax is a destination based tax and states generally tax things coming into the state and exempt things going outside the state. When I go to South Carolina and I buy something over the counter, to be sure I am going to pay a South Carolina sales tax.

In principle when I get back to Georgia I would owe a use tax and get a credit against the South Carolina sales tax but that is just a matter of cross-border shopping. No one tries to trace an over the counter transaction back to my destination. But I think it is fair to say that we have a destination-based sales tax in the U.S.

Mr. AKIN. A couple of others. Brian and then Paul.

Mr. BIERON. Just to mention that a couple of states who are in the effort to make their state taxes compliant with the SSTP concept have actually headed down the path that you are talking about which is switching from a source based internal state sales tax process because, of course, until Congress changes the law it would not apply to out-of-state sales.

But in a state, and I will use the example of Kansas, where they have different sales tax rates at the county level, and it is a state that has a huge number of counties, they have actually over the last couple of years headed down the path of trying to become internally compliant and changing their internal sales tax regime from a source based to a destination based. I know that at eBay we have had complaints from some sellers—

Mr. AKIN. I don't quite understand how that would work in Kansas.

Mr. BIERON. I will give you an example. I am not an expert on Kansas geography so I am afraid I might run into problems but I think Topeka and Lawrence, for example, are both inside Kansas. We have some eBay sellers who have been concerned that if they sell over eBay from Lawrence to Topeka that their sales tax requirements will have changed because currently let us say they have a store front. If somebody comes from Topeka and buys it in Lawrence, they charge the source tax rate whatever is the Lawrence tax rate. But if they mail the product, if they deliver the product into Topeka because they sell over eBay or over another Internet or—

Mr. AKIN. Are they worried that they have got to pay the—

Mr. BIERON. They would. Kansas was proposing to change the law inside Kansas and with hundreds and hundreds of different jurisdictions in Kansas that was really going to be a little test case of what this whole switch from source based to destination based would be like. I can tell you that those Kansas sellers have been extremely dismayed by this change. I know that there were a couple of years where Kansas deferred, essentially delayed the implementation of this because of the uproar from small businesses. It really makes it much more complicated. Of course, it can only happen right now inside a state.

Mr. AKIN. That means in Kansas the small business guy now has to know about all the jurisdictions within his own state. Not within the nation but within his own state.

Mr. BIERON. Right.

Mr. AKIN. Even that is a major headache for him.

Mr. BIERON. My understanding is that many of those small businesses their attitude has been essentially they are going to charge their local rate because it is just too complicated.

Mr. AKIN. It is just too complicated. And Kansas government is just going to have to put up or shut up.

Mr. BIERON. To be honest I don't think that the Kansas state government thinks that there is a huge revenue windfall from getting that compliance inside the state. But that is an example of what you are talking about and you can multiply it. I know that there are technology companies at the table who would describe on one hand how extraordinarily complicated this would be to go from just the complexity of one state or one county like Mr. Perry's store just in one place in North Carolina to the whole country.

Obviously I think we can all recognize that would be extraordinarily complicated. If a technology company were offering solutions, the fact is in the real world there is some relationship between how complicated something is, how much you have to have the service, and how much it ends up costing. If you require this mandate on everybody and it wasn't just, for example, inside Kansas but the whole country that there would be a cost and it would be a cost that small businesses operating on fairly narrow margins would really feel.

Mr. AKIN. Thank you.

Paul, I'll let you have a crack at that.

Mr. MISENER. Thanks, Mr. Chairman. I think I was going to say some of the same things that Brian was but it also helps to calibrate this whole thing. If we step back a second and look at what the Streamline Sales and Use Tax Agreement is all about, Missouri is not part of it. They are not in it and not part of it.

Mr. AKIN. Now you are getting personal.

Mr. MISENER. It doesn't apply to the territories outside at all. The states that are not party to it, the major ones, California, Texas, Illinois, all have the same source issue that Brian was describing. They currently have a longstanding rule of you buy something, if you live in Laredo and you buy it from Dallas, the retailer in Dallas makes the collection and sends it to the Dallas government.

To flip flop that, to become compliant with the Sales and Use Tax Agreement would be a huge internal upheaval in states like California, Texas, Illinois. New York is not part of it either. I mean, the major population centers of the country have not been in and that is a key reason why.

We have said at Amazon that we are going to collect for small businesses. We have a platform business and we are going to do it. We are a technology company. We are fairly sophisticated with computers. There are others that are as well. To small sellers I say that if Amazon can do it, your platform service provider also can do it almost certainly. If not, certainly you are welcome to come to Amazon.

Mr. Perry's business is perhaps the perfect example or the perfect kind of business to run through eBay. He is selling high value items that are very small and light. As a result, the opportunities for sales tax arbitrage are very great because the price differential between what is paid on-line and what is paid on main street is

very great, but the shipping costs are very low. You don't see many very successful eBay sellers that are selling, say, fertilizer which is just the opposite.

What we have just suggested is that at some level you just want to not have quirky sales tax exceptions that drive businesses unnecessarily into different directions. I really meant the point about the ballpoint pen. A lot of small business persons are required to drive to their place of employment. We don't expect them to make automobiles.

We don't expect them to make ballpoint pens to sign their legal documents but we still require them to sign in ink. This is a case where we don't expect small businesses to be pouring over tax tables in 7,600 jurisdictions and all that. There will be service providers. Amazon has said it has stepped up and said that, "We will do this." Eventually I would imagine others will as well.

Mr. AKIN. We have another member that is joining us. Would you like to jump into the discussion?

Mr. SODREL. No, I am just playing catch-up right now. Thank you. I may have some questions later.

Mr. AKIN. Okay. Let me just toss a different question out entirely. One of the things that is at least being theoretically, and maybe even more than theoretically looked at is tax simplification. There are two competing schemes out there right now.

One of them is the flat tax which has its own political problems and that is that every time you want to cut out an exemption somebody is going to offer an amendment so you end up with not a flat tax. That is one question. You take the basic income tax and you get rid of a whole lot of exemptions and the theory is you can file it on a card.

The competing alternative out there is the national sales tax. I guess my question is if we were thinking about it, and obviously that would require probably an appeal of the constitutional amendment that created the income tax so that is a big hurdle, too, politically. Let us say we were to get to the point where we are really looking at a national sales tax. How does that impact our discussion?

Mr. PERRY. I will speak to that briefly. In one of the papers this morning there is a little article about eBay complains about the European tax system. The Internet in Europe right now is really not growing anywhere like here in the states because of the complexity of the tax situation over there.

Basically some of the tax rates over there are from 15 to 25 percent, I understand, and it scares me to death to think that as a retailer I have got to charge if we go this national sales tax somewhere between 15 to 20 percent sales tax. It is going to drive a lot of business back to the underground into the flea markets. It will be devastating to our economy in my opinion. The flat tax is okay. I think that would be fine.

Mr. AKIN. Let me make a distinction, I didn't do this, between what is called a value added tax which is what the Europeans do. It is a great thing for politicians because you can crank it a fraction of a percent and just gain tremendous taxes. The trouble is it just kills the economies and that is why a lot of the European economies are really flat.

We are not talking about a value added tax. It would be over most of our dead bodies to do something like that. We are talking about a straight sales tax which is very different. The value added is every time something changes like if you are starting with a paper clip, you start with an ingot or whatever it is, and the Coke Company and whoever, the Ingot Company. The guy who has got the rolling mirror there is a tax there. Then there is a guy that rolls it and a guy that bends it. You have all these layers of taxes where we are talking about just simply a simple sales tax as opposed to value added.

Mr. PERRY. I am certainly not a tax expert but it just seems to me like if the burden is passed on as a national sales tax to retailers, we become the IRS in essence and I am not sure our customers are going to be real excited about looking on us in the same light they do now.

Mr. AKIN. Any other thoughts?

Mr. HELLERSTEIN. Yeah, just a few general observations. I am going to agree with Mr. Perry. I think at one level clearly we could not have a sales tax that substituted for the national income tax at the rates that we would need to generate the same amount of revenue and have it take the same form that we have.

Let me just give a clarification of the value added tax. The truth of the matter is that in the end a value added tax and a retail sales tax do precisely the same thing. The value added tax is simply collected at many points, that is on the intermediary. If I am General Motors and I buy steel, I pay a value added tax on that. When I sell the car and I collect a value added tax on my output, I get a credit against the tax that I paid. In the end the only person that pays a value added tax is the ultimate consumer.

Now, the truth is that if you are going to have something with rates from 15 to 25 percent as we have on a VAT, then you have to have it collected at each level because, as Mr. Perry correctly points out of the incentives to go to the black market. We have this in Europe, too with carousel fraud.

There is a lot of fraud because the rates are so high but at least there are a lot of collection points. I think that if we were to switch to a consumption tax which is way beyond the scope of what you people are focusing on, it is a huge question. I think we would almost have to go to a VAT from a mechanical and administrative standpoint. If we are going to have a national consumption tax it would almost have to be a VAT because you couldn't raise the revenues and rely on that final transaction, that 25 percent, as being the only place where we collected tax.

Mr. AKIN. That is interesting. It is maybe a little bit afield but, on the other hand, as people think about one thing, it does sort of affect our overall question about sales tax and how that is collected.

Brian, did you want to make a comment?

Mr. BIERON. No, just to say that certainly eBay doesn't generally take positions on broad tax reform, although we believe that if lower taxes incurred stronger economic growth, then that is good for everybody involved with the eBay market place.

I would say, though, that as a retail company at the end of day eBay is a retail market place and having the entire tax burden on

the retail business we think would hurt all the—again, eBay's success is tied entirely to the success of the sellers who actually do the business over eBay and we think those retailers—if all of the federal tax burden were put on the retail sector, that was the collection point, that would reduce consumption and hurt those sellers.

Mr. AKIN. Right. I am not going to do the counter argument for the national sales tax. It is an interesting discussion and it is sort of a little philosophical change whether you are taxing consumption or whether you are taxing income. I mean, there is a difference there in what you are trying to accomplish but I hear what you are saying.

Are there any other questions?

Ms. BORDALLO. I have none.

Mr. AKIN. Thank you all very much for attending today and helping us out with some of these difficult and vexatious items here. I appreciate your expertise. With that the hearing is concluded.

[Whereupon, at 11:11 a.m. the Subcommittee adjourned.]

W. TODD AKIN, MISSOURI
CHAIRMAN

MADELEINE Z. BORDALLO, GUAM
RANKING MINORITY MEMBER

Congress of the United States
House of Representatives
109th Congress
Committee on Small Business
Subcommittee on Regulatory Reform and Oversight
2361 Rayburn House Office Building
Washington, DC 20515–6319

Opening Statement
February 8, 2006
Regulatory Reform and Oversight Subcommittee
House Committee on Small Business
W. Todd Akin, Chairman

Good morning and welcome to today's hearing entitled "The Internet Sales Tax: Headaches Ahead for Small Business?" I want to especially thank those witnesses who have traveled to participate in today's hearing.

The Internet has emerged as an extremely important channel of commerce in our nation. For this reason, we must be vigilant in keeping this medium as unencumbered from regulations and taxes as possible. I oppose anything that constitutes a new tax or imposes new onerous regulations on our nation's businesses, especially those selling over the Internet.

We are here to investigate recent federal and state efforts to shift responsibility to collect state sales and use taxes to out-of-state Internet vendors. A state currently can not impose that burden unless a business has a constitutionally significant presence or "substantial nexus" within the state. Because e-commerce has become a vital channel for businesses of all sizes, many states are concerned with the loss of potential tax revenue. Consequently, these states have banded together to form the Streamlined Sales and Use Tax Agreement, which is an effort to harmonize sales and use tax laws and simplify tax collection for vendors. Member states of this agreement argue that by creating a more uniform system of laws in this nation and easing burdens on vendors, they in turn should be given the authority by Congress to collect sales and use taxes from out-of-state Internet vendors.

Currently, two nearly identical bills have been introduced in the Senate that would provide such authority to states. Both measures include an exception from remote sales and use tax collection for small businesses. However, the bills differ in how this should be accomplished. Thus far, no companion legislation has been introduced in the House.

Today our panelists will address the many issues surrounding implementation of the Streamlined Sales and Use Tax Agreement. Particular emphasis will be placed on the scope of the current federal legislation and the many new compliance burdens that could be placed on our nation's businesses if this legislation is enacted.

I look forward to the testimony from our witnesses today. I now yield for an opening statement from the gentlelady from Guam, Ms. Bordallo.

Congresswoman Madeleine Z. Bordallo
Statement for Committee on Small Business Hearing
"Internet Sales Tax: Headaches Ahead for Small Business"
Rayburn 2360 (1000)
February 8, 2006

Statement

Thank you, Mr. Chairman for holding this hearing to review the application of a sales tax to Internet commerce and the effect this would have on the vitality of American small businesses. I look forward to hearing the testimony of the witnesses before us today.

I represent Guam. Being way out there in the Pacific, Internet-based commerce is particularly important to my constituents. The advent of the Internet and the massive growth of the e-commerce sector have certainly opened up a wealth of opportunity for businesses owners and consumers on Guam and across the country. Online sites such as Amazon.com, E-Bay, and countless others have allowed sellers and buyers have made easier the purchasing of goods and services at a competitive price.

Internet-based commerce has had a notable positive impact on the U.S. economy, and has resulted in tens of thousands of new highly skilled and high-paying jobs. Expectations are that the Internet commerce industry will continue to grow in the coming years. For example, retail e-commerce sales projected to top $80 billion for Fiscal Year 2005 – which is up from the $69.2 billion in online retail sales generated in Fiscal Year 2004.

Many small businesses will contribute to and benefit from this growth. The Internet allows them to expand their markets at marginal additional cost, allowing them to compete more fairly with their larger counterparts.

However, the uncertainty of the sales tax treatment of goods sold over the Internet is a major obstacle for many small businesses entering into Internet-based commerce. In particular, the collection and remittance of taxes on Internet commerce is a complex and costly problem from small businesses to solve. Currently, online buyers are taxed according to where the item they purchase will be delivered, as opposed to where the vendor is located. The opposite is the case with traditional over the counter sales in traditional businesses. A buyer from Guam who makes a purchase from a store in Virginia will pay Virginia sales tax.

Because tax law varies from state to state and among U.S. territories, small businesses, many of which only have a few employees, face difficulty in complying with the complexity of these various tax codes and a barrage of federal regulations they need to follow. Although the Internet may be able to quickly connect you to every community across the U.S., knowing the particulars for the roughly 7,500 distinct tax jurisdictions in the U.S. is quite a daunting task even for the most talented of entrepreneurs.

The application of a sales tax to Internet commerce would appear to be a potential to curb the further growth of this unique sector of the American economy.

Today's hearing will provide us with an opportunity to hear more about this issue in an effort to better understand the potential impact of tax collection on small online retailers. I am particularly interested in hearing more on how these changes will impact the future development of our nation's 23 million small businesses – many of which have already tried their hand at Internet sales.

Thank you.

DONNA M. CHRISTENSEN
DELEGATE, VIRGIN ISLANDS

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RANKING MEMBER, SUBCOMMITTEE ON NATIONAL PARKS

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SUBCOMMITTEE ON REGULATORY REFORM AND OVERSIGHT

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February 8, 2006

CONGRESSWOMAN DONNA M. CHRISTENSEN'S STATEMENT BEFORE THE SMALL BUSINESS SUBCOMMITTEE ON REGULATORY REFORM AND OVERSIGHT HEARING ON "THE INTERNET SALES TAX: HEADACHES FOR SMALL BUSINESSES?"

Thank you Chairman Akin and Ranking Member Bordallo for holding this hearing on the internet sales tax and small businesses. This is an important hearing considering that the Internet Tax Moratorium – which prevents the collection of Internet access taxes and other "new" taxes on the Internet – is scheduled to expire in 2007. Soon we will be faced with the issues of whether internet taxes should be collected and if yes, who and how should it be done. Should the state be responsible for collecting its own taxes or should the burden be on the businesses profiting from Internet sales?

A survey conducted by ACNielsen found that the Internet equals profits for more than half of the 400 small businesses that participated in the survey. The Internet and eBay have enriched the opportunities for small business success. The possibility of small businesses collecting state taxes sounds like a daunting task that could possibly discourage them from using this very important and profitable tool. Taxes are an

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important, if not the primary, source of revenue for states to improve state services. But, even with proposed legislation emphasizing uniformity, standardization and simplification in state tax law, small businesses will still be burdened if required to collect taxes and comply with yet another tax code. Small businesses are already burdened with sorting through and complying with the myriad of tax laws.

The Virgin Islands has no sales tax and has never had one. Every time the prospect of taxes being imposed on internet sales is raised, I get an onslaught of e-mails from Virgin Islands consumers voicing their concern about such a tax. Beyond my constituents' concerns, I am concerned about the burden that Internet tax collection would have on small businesses overall. Tax compliance and collection is a very complicated subject and I look forward to our witnesses providing us with an understanding of the implications of collecting Internet sales tax. I welcome our witnesses and look forward to their testimonies.

Testimony of Walter Hellerstein

Before the

Subcommittee on Regulatory Reform and Oversight

Of the
Committee on Small Business
United States House of Representatives

Hearing on

"The Internet Sales Tax: Headaches Ahead for Small Business?"

Framing the Debate Over the Need for Federal Legislation Addressing State Taxation of Internet Sales: A Primer on Existing Law and the Policy Choices Facing Congress

February 8, 2006

I am Walter Hellerstein, the Francis Shackelford Professor of Taxation at the University of Georgia School of Law. I have devoted most of my professional life to the study and practice of state taxation and, in particular, to state taxation of interstate commerce and the federal constitutional restraints on such taxation.

I am honored by the Chairman's invitation to testify today. I welcome the opportunity to share with the Subcommittee my views on the existing legal framework governing state taxation of sales made over the Internet and the policy issues that Congress faces with regard to such taxation. I do not appear here on behalf of any client, public or private, and the views I am expressing here today reflect my independent professional judgment.

My testimony is divided into three parts. Part I describes the legal framework that currently governs state taxation of Internet sales, including the underlying state tax regimes and the federal constitutional and statutory restraints on those regimes. Part II considers Congress's power to prescribe the rules that it believes are appropriate for state taxation of Internet sales. Part III delineates the policy choices that Congress faces in determining whether it should modify the existing rules governing state taxation of Internet sales.

I. CURRENT LEGAL FRAMEWORK GOVERNING STATE TAXATION OF INTERNET SALES

In describing the current legal framework governing state taxation of Internet sales, I would like to focus on three sets of questions:

(1) What is the basic structure of the states' sales tax laws and how do these laws apply to sales over the Internet?

(2) What are the existing federal constitutional restraints on the states' power to impose sales taxes and how do those restraints limit the states' ability to apply their laws to sales over the Internet?

(3) What are the existing federal statutory restraints on the states' power to impose sales taxes and how do those restraints limit the states' ability to apply their laws to sales over the Internet?

A. The Structure of State Sales Tax Laws

Probably the most significant structural feature of existing state sales tax laws insofar as they apply to Internet sales is that state sales taxes generally apply only to sales of tangible personal property and not to most sales of digital products, services, or intangible property. While a few states tax a wide range of services and digital products (including information and data processing services and access to data bases), and many states tax some services and digital products (such as telecommunications services and digital downloads), most state sales taxes are limited to sales of tangible personal property.

Accordingly, if one divides the universe of Internet sales into two broad categories – transactions involving sales of tangible personal property and transactions involving sales of services and digital products, it is only the first category of transactions that generally falls within the scope of the states' sales taxes. Thus, if one buys a book from Amazon.com by clicking on its Web site or a computer from Dell by clicking on its Web site, it is clear that most states will seek to tax that purchase, just as if one walked into a store to buy a book or a computer. On the other hand, if one accesses an information data base over the Internet, or purchases plane tickets over the Internet, or trades stocks over the Internet, or enrolls in distance learning courses over the Internet, or enjoys so-called adult entertainment over the Internet, most of those transactions would not be subject to tax in the overwhelming majority of states.

This is not to suggest that tomorrow the states could not change their sales tax laws to include such transactions in the tax base. Nor do I mean to imply that there will not be pressures on states to expand their sales tax bases to include digital transactions, in light of the enormous shift towards, and increase in, commerce in digital form. It is only to make the simple point that right now the states generally seek to tax only a small portion of the universe that we regard as Internet sales. Accordingly, insofar as this Subcommittee is concerned with the "headaches ahead for small business" caused by the "Internet sales tax," this is – for the moment at least – a contemporary version of the familiar problem of state taxation of mail-order and other remote sales of tangible personal property.

B. Federal Constitutional Limitations on State Taxation of Internet Sales

Insofar as the states do seek to impose taxes on Internet sales (i.e., sales consummated over the Internet, but usually involving tangible personal property), the next question is what are the existing federal constitutional restraints on their ability to do so? To appreciate fully my somewhat extended answer to this question, we must start with an understanding of the constitutional structure governing the power of states to tax interstate sales. To do this we must begin with an explanation of a use tax.

When states first enacted sales taxes during the Depression, they faced the problem that they would lose revenue, and their merchants would lose business, if their residents shopped in neighboring states without sales taxes (or with sales taxes with lower rates). Under the judicially articulated restraints imposed on the states under the Constitution's Commerce and Due Process Clauses,[1] it has always been clear that one state may not impose a sales tax on a sale that occurs in another state. To address this problem, states enacted use taxes.

A use tax is imposed on the use, storage, or consumption of tangible personal property and selected services in the state. It is functionally equivalent to a sales tax. It is imposed with respect to the same transactions and at the same rates as the sales tax that would have been imposed on the transaction had it occurred within the state's taxing jurisdiction. However, because the use, storage, or consumption of property or services

[1] U.S. Const. art. I, § 8, cl. 3; U.S. Const. amend. XIV, § 1.

within the state are subjects within the state's taxing power, there is no constitutional objection to the imposition of such a tax[2] – as there would be with regard to a tax on an out-of-state sale.

In principle, then, an in-state consumer stands to gain nothing by making an out-of-state or interstate purchase free of sales tax, because he will ultimately be saddled with an identical use tax when he uses, stores, or consumes the property or services in his home state. If, for example, a Washington resident were to go to Oregon to purchase a car, she would pay no sales tax in Oregon, which does not tax sales, but she would pay use tax in Washington, when she went to register her car, equal to the sales tax that she would have paid had she bought the car in Washington. Every one of the 45 states and the District of Columbia that has sales taxes also imposes complementary use taxes.

In theory, the basic sales/use tax regime that I have just described applies to sales over the Internet in the same manner that it applies to transactions involving automobiles. Thus, if I buy a book from Amazon.com, and it is shipped to me in Athens, Georgia, there is no question that I will owe a Georgia use tax equal to the sales tax that I would have paid had I bought the book in a bookstore in Athens.

There is, however, one significant difference between the purchase from Amazon.com and the purchase of the automobile I described above. With respect to the purchase of the automobile, the state has a practical means of requiring the purchaser to pay the use tax – namely, collecting it upon registration of the vehicle. But states do not require that consumers register books they purchase (and presumably will not be able to do so long as we have a First Amendment). Consequently, unless the consumer voluntarily remits the use tax on the purchase from the out-of-state vendor, which consumers rarely do notwithstanding their legal obligation to do so, the state has no practical means for collecting the use tax unless it can require the out-of-state vendor to collect the use tax in the same way that it relies on the in-state vendor the collect the sales tax.

It is at this point of the legal analysis that we confront the principal constitutional constraint the states face in connection with sales and use taxation of Internet sales – and, I may add, in connection with sales and use taxation of all remote commerce including mail-order sales – namely, that unless the out-of-state vendor has a substantial connection or "nexus" with the state, the states lack the constitutional power to require the vendor to collect the use tax that the consumer owes with respect to the purchased item.

In *National Bellas Hess, Inc. v. Department of Revenue*,[3] decided in 1967, the U.S. Supreme Court held that the Commerce and Due Process Clauses prohibited a state from imposing a use tax collection obligation on a mail-order seller with no physical presence in the state. Twenty-five years later in 1992, the Court in *Quill Corp. v. North Dakota*[4]

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[2] *See Henneford v. Silas Mason Co.*, 300 U.S. 577 (1937) (sustaining constitutionality of state use tax scheme).

[3] 386 U.S. 753 (1967).

[4] 504 U.S. 298 (1992).

reaffirmed the essential holding of *Bellas Hess* – namely, that states may not require a mail-order seller without physical presence in the state to collect the use tax due on goods sold to in-state purchasers, although it rested its decision entirely on the Commerce Clause.[5] Central to the Court's Commerce Clause holding in *Bellas Hess* and *Quill* – and to the issue before this Subcommittee and Congress – was the perceived burden that the duty of collection of taxes on remote sales imposed on interstate commerce in light of the complexity of the nationwide pattern of state and local sales taxes:

> North Dakota's use tax illustrates well how a state tax might unduly burden interstate commerce. On its face, North Dakota law imposes a collection duty on every vendor who advertises in the State three times in a single year. Thus, absent the *Bellas Hess* rule, a publisher who included a subscription card in three issues of its magazine, a vendor whose radio advertisements were heard in North Dakota on three occasions, and a corporation whose telephone sales force made three calls into the State, all would be subject to the collection duty. What is more significant, similar obligations might be imposed by the Nation's 6,000- plus taxing jurisdictions. See *National Bellas Hess* ... (noting that the "many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle [a mail-order house] in a virtual welter of complicated obligations").[6]

To conclude this discussion of the federal constitutional restraints on state sales and use taxation of Internet sales, it is clear under existing law that states possess the constitutional power to impose a tax on the in-state use, storage, or consumption of tangible personal property sold over the Internet. It is equally clear, however, that states lack the constitutional power to require a non-physically present, out-of-state vendor to collect use taxes that a state may seek to impose on the in-state use of such property. As a consequence, any use taxes that a state may impose on property acquired through Internet purchases from non-physically present vendors are likely to go uncollected, just as use taxes that are legally due on many interstate mail-order or telephone sales currently go uncollected.

C. Federal Statutory Limitations on State Taxation of Internet Sales

In addition to the federal constitutional limitations on state taxation of Internet sales – or, more accurately, on state use tax collection obligations imposed on remote Internet vendors – Congress imposed additional limitations on state taxation of Internet-related transactions in the Internet Tax Freedom Act (ITFA). Although these limitations are narrow in scope and do not significantly alter the constitutional landscape described above, a brief

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[5] The significance of the precise constitutional basis for the physical-presence requirement, which may seem like a technical debating point, is that Congress is clearly free to change the rules that the Court articulates under the Commerce Clause, whereas there is serious question whether Congress can change rules the Court articulates under the Due Process Clause. I will return to the implications of this distinction in Part II of my testimony.

[6] *Quill*, 504 U.S. at 313 n.6.

description of these provisions is nevertheless appropriate to complete the picture of federal restraints on state taxation of Internet sales.

In 1998, Congress enacted the Internet Tax Freedom Act (ITFA).[7] The Act imposed a three-year moratorium (subsequently extended through 2007[8]) on three types of taxes: (1) taxes on Internet access; (2) discriminatory taxes on electronic commerce; and (3) multiple taxes on electronic commerce.

1. Taxes on Internet Access

The prohibition against taxes on Internet access forbids states from taxing charges for "a service that enables users to access content, information, electronic mail or other services over the Internet."[9] ITFA plainly forbids states from taxing the monthly fee that America Online and other Internet access providers charge to their customers for connecting to the Internet. The original prohibition contained a flat exclusion of telecommunications services from the definition of Internet access. The 2004 extension of the moratorium added language making it clear that all forms of Internet access were covered by the moratorium, including high speed wireline (DSL) and wireless service (i.e., telecommunications services "purchased, used, or sold by a provider of Internet access to provide Internet access"[10]).

The original act grandfathered preexisting state taxes on Internet access by excluding from ITFA's scope any tax that "was generally imposed and actually enforced prior to October 1, 1998."[11] Although that provision has been extended through 2007, a more limited grandfathering provision for states that were taxing the telecommunications services that were covered by the moratorium for the first time (i.e., telecommunications services purchased, used, or sold to provide Internet access) were grandfathered only through November 1, 2005. The 2004 extension of ITFA also makes it clear that the prohibition does not apply to any tax for a voice or similar service using Internet Protocol (voice over Internet Protocol or VOIP), except to the extent the services are incidental to the Internet access such as voice-capable email or instant messaging.

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[7] Pub. L. No. 105-277, §§ 1101-04, 112 Stat. 2681-719 to 2681-726 (1998). For a general discussion of ITFA, see Walter Hellerstein, "Internet Tax Freedom Act Limits States' Power to Tax Internet Access and Electronic Commerce," 90 *Journal of Taxation* 5 (January 1999).

[8] In November 2001, Congress retroactively extended ITFA for two years through October 2003. "Internet Tax Nondiscrimination Act," H.R. 1522, 107th Cong., 1st Sess. (2001). In late 2004, Congress again retroactively extended the act, with some modifications, this time though November 2007. Pub. L. No. 108-435, 118 Stat. 2615 (2004).

[9] ITFA § 1104(5).

[10] Pub. L. No. 108-435, § 2(c) 118 Stat. 2615, 2616 (2004).

[11] ITFA § 1101(a)(1).

2. Discriminatory Taxes

The Act's prohibition against discriminatory taxes on electronic commerce would have had little impact had it been confined to that concept as it is generally understood, since there are no taxes of which I am aware that single out transactions in electronic commerce for invidious treatment. However, because Congress defined "discriminatory taxes" to include certain taxes in which a remote seller has only minimal nexus with the state, ITFA may have limited impact with respect to use tax collection obligations. Specifically, Congress classified as "discriminatory" any tax (other than a grandfathered tax on Internet access), if the "sole ability to access a site on a remote seller's out-of-State computer server is considered a factor in determining a remote seller's tax collection obligation."[12] In substance, this provision forbids states from imposing taxes on Internet sales by "remote" (i.e., non-physically present) sellers, if the state relied on the purchaser's "sole ability" to access the seller's out-of-state computer server as a factor in determining whether the remote seller has nexus with the state and, consequently, an obligation to collect a tax on the transaction.[13] ITFA also prevents the states from claiming that they have nexus with a remote seller for purposes of requiring the remote seller to collect a use tax on its Internet sales into the state by characterizing an Internet access provider (e.g., America Online) as the remote seller's agent "solely as a result of (I) the display of a remote seller's information or content on the out-of-State computer server" of the Internet access provider or "(II) the processing of orders through the out-of-State computer server" of the Internet access provider.[14]

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[12] ITFA § 1104(2)(B).

[13] This provision contains a fundamental ambiguity: whether the critical phrase "a remote seller's *out-of State* computer server" – which a state is barred from considering in determining the out-of-state seller's nexus with the state – should be read from the vantage point of the taxing state or from the vantage point of the seller. If read from the perspective of the taxing state, which is the more natural reading, the provision is redundant with existing constitutional jurisprudence and is thus virtually meaningless. It would prevent a state from asserting nexus over an out-of-state Internet seller if the state relied solely on the seller's computer server *in some other state* as a factor in considering whether the taxpayer had nexus in the taxing state. But existing constitutional law would preclude an assertion of jurisdiction in these circumstances. Hence, thus construed, the provision adds nothing to existing constitutional protections. If the phrase "a remote seller's *out-of-State* computer server" is read from the standpoint of the seller, so that a state would be forbidden from imposing a use tax collection obligation on a remote Internet seller based exclusively on the presence of the seller's server in the taxing state, then the provision would have some theoretical significance, but not much practical impact. Most states have indicated that they would not assert jurisdiction over an out-of-state seller based solely on the presence of the out-of-state seller's server in the state.

[14] ITFA § 1104(2)(B)(ii). This provision contains an ambiguity similar to that contained in the provision described above, see *supra* note 13, whether the "*out-of-State* computer server" – which a state is barred from considering in determining whether the Internet access provider is the agent of the remote seller – should be read from the vantage point of the taxing state or from the vantage point of the seller. For reasons set forth above, the provision would have meaning only if read from the standpoint of the seller. Thus read, it prevents a state from asserting nexus over an out-of-state Internet seller if the state relied solely on the Internet access provider's computer server in the taxing state as a factor in considering whether the Internet access provider was the remote seller's nexus-creating agent in the taxing state. Construed from this perspective, the provision essentially forbids the states from invoking an "attributional nexus" theory based

3. Multiple Taxes on Electronic Commerce

ITFA's prohibition of multiple taxation of electronic commerce is not a model of clarity. A multiple tax is defined as

> any tax that is imposed by one State ...on the same or essentially the same electronic commerce that is also subject to another tax imposed by another State ... (whether or not at the same or rate or on the same basis), without a credit (for example, a resale exemption certificate) for taxes paid in other jurisdictions.[15]

Congress excluded from this definition of a "multiple tax" sales or use taxes imposed concurrently by a state and its political subdivisions on the same electronic commerce and "a tax on persons engaged in electronic commerce which may also have been subject to a sales or use tax thereon."[16] Although one can discern Congress' objective in enacting this provision – to prevent the same electronic commerce from being subject to tax by more than one state – the language that Congress chose to accomplish that goal was opaque at best. While a prohibition against one state taxing "the same electronic commerce" that is subject to tax in another state might leave some room for debate, the prevention of states from taxing "*essentially* the same electronic commerce" seems almost to invite controversy. To date, however, none appears to have arisen, perhaps because states generally provide a credit against their use taxes for sales taxes paid to other states and the "savings clause" for taxes imposed on persons engaged in electronic commerce removes most other taxes from the scope of the prohibition.

II. CONGRESS'S POWER TO ADOPT RULES IT DEEMS APPROPRIATE FOR STATE TAXATION OF INTERNET SALES

Part II of my testimony considers Congress's power to prescribe the rules that govern state taxation of Internet sales. There should be no serious debate over Congress's broad authority to adopt or consent to virtually any rule that it believes is appropriate in this domain.

First, it is critical to understand that the judicially developed restraints on state taxing power that the Court has articulated under the Commerce Clause are simply irrelevant in determining the scope of congressional authority to exercise its affirmative "Power . . . [t]o regulate commerce among the several States . . . ."[17] Those judicially developed restraints on state taxing power, which the Court has delineated under the so-

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solely on the remote seller's use of the Internet access provider's in-state server.

[15] ITFA § 1104(6)(A).

[16] ITFA § 1104(6)(B).

[17] U.S. Const. art. I, § 8, cl. 3.

called "dormant" or "negative" Commerce Clause, are controlling only when Congress itself has not exercised the constitutional authority that it enjoys under the Commerce Clause. When Congress exercises its own power under the Commerce Clause, it may consent to state legislation affecting interstate commerce that would be unconstitutional under the "dormant" Commerce Clause in the absence of such consent, and it may preempt state legislation that would be constitutional under the dormant Commerce Clause in the absence of such preemption.

As the U.S. Supreme Court has declared, the "plenary scope" of the congressional commerce power

> enables Congress not only to promote but also to prohibit interstate commerce, as it has done frequently and for a great variety of reasons. That power does not run down a one-way street or one of narrowly fixed dimensions. *Congress may keep the way open, confine it broadly or closely, or close it entirely*, subject only to the restrictions placed upon its authority by other constitutional provisions and the requirement that it shall not invade the domains of actions reserved exclusively for the states.[18]

Second, in light of Congress's broad power to legislate under the Commerce Clause, we can now appreciate the significance of the Court's having rested its holding in *Quill* entirely on the Commerce Clause. Because the Court based the physical-presence requirement for mandatory collection of use taxes exclusively on the Commerce Clause, Congress clearly retains ample power to modify that rule (as well as any other rule the Court has articulated under the Commerce Clause) in forging a legislative solution to the problems raised by state taxation of Internet sales. Indeed, the Court could not have been more explicit about this point in *Quill*. Thus, in justifying its refusal to renounce the "bright-line" physical-presence test of *Bellas Hess*, the Court declared:

> 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. No matter how we evaluate the burdens that use taxes impose on interstate commerce, Congress remains free to disagree with our conclusions. Indeed, in recent years Congress has considered legislation that would "overrule" the *Bellas Hess* rule. Its decision not to take action in this direction may, of course, have been dictated by respect for our holding in *Bellas Hess* that the Due Process Clause prohibits States from imposing such taxes, but today we have put that problem to rest. Accordingly, *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.*[19]

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[18] *Prudential Insurance Co. v. Benjamin*, 328 U.S. 408, 434 (1946) (emphasis supplied).

[19] *Quill*, 504 U.S. at 318 (footnotes and citations omitted, emphasis supplied). In a similar vein, but in a slightly different context, the Court has declared that "[i]t is clear that the legislative power granted by the Commerce Clause of the Constitution to Congress would amply justify the enactment of legislation requiring all States to adhere to uniform rules for the division of income." *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267, 280 (1978).

Finally, let me briefly address the limitations on Congress's power to enact legislation expanding, restricting, or otherwise prescribing rules governing state taxation of Internet sales. It is true that some of the Court's more recent decisions construing Congress's affirmative power under the Commerce Clause have taken a narrower view of that power than the Court articulated during the New Deal era,[20] when it sustained the broad exercise of congressional power to regulate even local activities that may affect interstate commerce.[21] But these decisions do not seriously inhibit the extensive power that Congress plainly possesses to deal with the problems raised by state taxation of Internet sales for the reasons stated by the Court itself.[22]

III. POLICY CHOICES FACING CONGRESS

Legislation has been introduced into Congress authorizing the states, under specified conditions, to require collection of sales and use taxes with respect to sales by remote sellers, notwithstanding their lack of physical presence in the state (otherwise constitutionally required under the *Quill* decision), if the states conform to the provisions of the Streamlined Sales and Use Tax Agreement (SSUTA).[23] The fundamental purpose of SSUTA is "to simplify and modernize sales and use tax administration in the member states in order to substantially reduce the burden of tax compliance."[24] The proposed congressional legislation declares that it is the "sense of Congress" that SSUTA – to the extent that it meets congressionally prescribed simplification requirements (which generally track those embodied in SSUTA) –

> provides sufficient simplification and uniformity to warrant Federal authorization to Member States that are parties to the Agreement to require remote sellers, subject to the conditions provided in this Act, to collect and remit the sales and use taxes of such Member States and of local taxing jurisdictions of such Member States.[25]

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[20] *See United States v. Morrison*, 529 U.S. 598 (2000) (Congress lacks the power under the Commerce Clause to provide a civil remedy for victims of gender-motivated violence because gender-motivated crimes do not substantially affect interstate commerce); *United States v. Lopez*, 514 U.S. 549 (1995) (Congress lacks the power under the Commerce Clause to prohibit possession of firearms in school zones because possession of a gun in a local school zone does not affect interstate commerce).

[21] *See, e.g., Wickard v. Filburn*, 317 U.S. 111 (1942) (sustaining Congress's power to regulate under the Commerce Clause the amount of wheat a farmer grew for his own consumption).

[22] *See generally* Walter Hellerstein, "Federal Constitutional Limitations on Congressional Power to Legislate Regarding State Taxation of Electronic Commerce," 53 *National Tax Journal* 1307 (2000).

[23] For a detailed description and analysis of SSUTA, see Walter Hellerstein & John A. Swain, *Streamlined Sales and Use Tax* (Warren Gorham & Lamont, Rev. ed. 2005).

[24] SSUTA § 102.

[25] "Streamlined Sales Tax Act Simplification Act," S. 2153, 109th Cong., 1st Sess. § 3 (Dec. 20, 2005); "Sales Tax Fairness and Simplification Act," S. 2152, 109th Cong., 1st Sess. § 3 (Dec. 20, 2005).

The proposed legislation declares that "[t]he Congress consents to the ... Streamlined Sales and Use Tax Agreement."[26] This explicit consent, coupled with the "sense of Congress" language quoted above reflecting Congress's intent in granting such consent, removes any Commerce Clause barrier to any member state's requirement that remote vendors collect sales or use taxes on sales to in-state consumers. If the states satisfy SSUTA's requirements, Congress would authorize mandatory collection by remote sellers, but with additional conditions and limitations beyond those required by SSUTA. These include, among other things, a "small business exception" (which is defined differently in the two legislative proposals),[27] reasonable seller compensation (including compensation that covers all tax-processing costs of remote sellers), and federal court review of controversies arising under SSUTA.

The fundamental policy questions the proposed legislation raises for Congress may be simply stated (which is *not* the same thing as saying that the question is simple):

> Does the legislation provide sufficient simplification and related protections (e.g., vendor compensation) to justify modification of the constitutional rule that a physically remote vendor has no obligation to collect use taxes on taxable items sold to purchasers within a state?
>
> If so, what are the appropriate standards for requiring remote vendors to collect use taxes on items sold to purchasers within a state?

My testimony does not purport to answer these questions[28] or, indeed, even to provide this Subcommittee with the essential facts it will need to answer these questions. Rather the balance of my testimony is designed to assist the Subcommittee in identifying the key criteria upon which it should focus in seeking to answer these questions. In other words, the balance of my testimony is designed to assist the Subcommittee in its effort to determine under what conditions, if any, it would be desirable as a matter of policy to relax or modify the law as it now stands governing use tax collection by out-of-state

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[26] "Streamlined Sales Tax Act Simplification Act," S. 2153, 109th Cong., 1st Sess. § 2 (Dec. 20, 2005); "Sales Tax Fairness and Simplification Act," S. 2152, 109th Cong., 1st Sess. § 2 (Dec. 20, 2005).

[27] The "Streamlined Sales Tax Act Simplification Act," S. 2153, 109th Cong., 1st Sess. § 4(d) (Dec. 20, 2005), leaves the definition of a "small business" to be determined by the Small Business Administration, subject to congressional review. The "Sales Tax Fairness and Simplification Act," S. 2152, 109th Cong., 1st Sess. § 4(d) (Dec. 20, 2005), defines a small business as a "seller and its affiliates" that "collectively had gross remote taxable sales nationwide" of less than $5 million in the year preceding the date of the sale or a "seller and its affiliates" that met the $5 million threshold but where "the seller had less than $100,000 in gross taxable sales nationwide." Except for the differing "small business" exceptions, the two legislative proposals are identical.

[28] My views, however, along with those of Charles E. McLure, Jr., on the merits of an earlier (but substantially similar version) of this legislation are contained in Charles E. McLure, Jr. & Walter Hellerstein, "Congressional Intervention in State Taxation: A Normative Analysis of Three Proposals," *State Tax Notes*, March 1, 2004, p. 721 (also in *Tax Notes*, March 15, 2004, p. 1350).

vendors, and, if such relaxation or modification is appropriate, what criteria should govern the determination whether a remote vendor has a duty to collect use taxes.

A. Key Policy Choice *Not* Facing Congress: Whether Internet Sales of Tangible Personal Property Consummated Over the Internet Should Be Taxed

Let me begin with a one policy choice that, in my judgment at least, plainly is *not* facing Congress or this Subcommittee, namely, whether tangible personal property purchased over the Internet should be taxed. In my view, that is a policy choice that is appropriately made by the individual states, and, as indicated in Part I of my testimony, 45 of the 50 states (and the District of Columbia) have already made that choice. The only question before Congress is whether the states in seeking to collect the taxes that indisputably are owed on property used within their borders can require out-of-state vendors to collect the tax, just as states require in-state vendors to collect the tax.

B. Criteria Bearing on Determination Whether and, If So, How to Modify Existing Law Governing Vendor Collection of Use Tax on Remote Sales

As noted above, the fundamental policy questions facing Congress (and this Subcommittee) are (1) whether the proposed legislation provides sufficient simplification and related protections (e.g., vendor compensation) to justify modification of the constitutional rule that a physically remote vendor has no obligation to collect use taxes on taxable items sold to purchasers within a state; and if so, (2) what are the appropriate standards for requiring remote vendors to collect use taxes on items sold to purchasers within a state? Although there are no easy answers to these questions, I would urge the Subcommittee to focus on the following criteria in attempting to arrive at answers:

- Costs of collecting sales and use taxes under the proposed regime
- Additional revenues collected under proposed regime
- Relationship between nationwide gross sales and nationwide costs of collection
- Relationship between gross sales nationwide and costs of collection in a particular state
- Relationship between physical presence in a state and costs of collection in a state
- Relationship between costs of collection and separate legal identity of an entity that controls, is controlled by, or is under common control of a seller

I am aware that each of these criteria requires a factual determination for which there may be no hard data, at least for the moment. Nevertheless, it seems to me that one cannot make an informed judgment about the wisdom of changing the existing rules without having some practical sense of the costs and benefits of doing so. I doubt anyone would favor changing a rule that imposed $1 of increased compliance costs for every penny of revenue raised from taxes that everyone agrees are legally due (i.e., a use tax on in-state consumption). By the same token, I doubt anyone would resist changing a rule that permitted collection of $1 of revenue for every penny of increased compliance costs,

at least if those who bore the increased costs were reimbursed for them.

It may well be, of course, that even the existing rules make no sense from a policy perspective. For example, it may well be that a rule dependant entirely on physical presence could ensnare a small Mom and Pop operation in the use tax collection regime of a state into which it happens to send a single salesperson, whereas a multimillion dollar retailer with sophisticated tax collection and remittance personnel and software, but with no physical presence in the state, would have no use tax collection duty. Whether this makes sense depends on the facts that will no doubt be presented to this Subcommittee. My point is simply that without such facts it is virtually impossible to make an informed judgment about whether the existing rules are appropriate and, if not, how they should be changed to reflect economic reality and fairness to remote vendors and states alike.

C. Sourcing Issues

Before completing my testimony, I would like briefly to address one particular area of concern, the so-called "sourcing" provisions of SSUTA. SSUTA identifies the provision of "[u]niform sourcing rules for all taxable transactions"[29] as one of the essential features of the streamlined system designed to "simplify and modernize sales and use tax administration."[30] In implementing this requirement, SSUTA adopts a set of "general" sourcing rules for most transactions.[31] These rules broadly embrace the destination principle, and they apply in a hierarchical sequence depending on the circumstances surrounding the particular transaction (e.g., where the product is received) and the availability of information regarding the destination or the constructive destination of the sale (e.g., the purchaser's address). These general provisions apply in principle "regardless of the characterization of a product as tangible personal property, a digital good, or a service."[32]

SSUTA provides a hierarchical or prioritized series of five general sourcing rules for the sale of all products except those specifically sourced under other provisions or excluded from SSUTA's scope altogether.

1. When a purchaser receives a product in an over-the-counter transaction at the seller's business location, the sale is sourced to that business location.
2. When (1) does not apply, the sale is sourced to the location where the

[29] SSUTA § 102(F).

[30] SSUTA § 102.

[31] SSUTA §§ 310(A), 311.

[32] SSUTA § 309(A).

purchaser receives the product – typically, the purchaser's "ship to" or delivery address – if the seller knows the location.

3. When (1) and (2) do not apply, the sale is sourced to the purchaser's address if it is available from the seller's business records.
4. When (1), (2), and (3) do not apply, the sale is sourced to the purchaser's address obtained during the consummation of the sale (including the address of the purchaser's payment instrument).
5. When none of the foregoing rules applies, the source of the sale is its origin (i.e., the point from which property was shipped, from which digital products were transmitted, or from which services were provided).[33]

These rules are designed to implement the underlying principle that a sale should be sourced on a destination basis.[34] In so doing, they take into account the information about the destination that a seller could reasonably be expected to possess at the time of the sale. In the case of an over-the-counter sale or a sale with a geographically determinate "ship to" or delivery address, the sourcing rules follow the physical flow of the product. When physical product flows cannot be determined, the sourcing rules rely on the purchaser's address when the seller is in a position to know that address. Finally, recognizing that there may well be situations in which one cannot reasonably determine the destination of a sale on the basis of available information regarding physical flows or the seller's address, SSUTA adopts an origin-based sourcing principle as a default rule.

Although there is an acute need for uniform sourcing rules if sales and use taxes are to be simplified, and the SSUTA sourcing provisions address that need, they do create a problem for certain intrastate "cross-border" transactions. In other words, the sourcing issue arises not only in the interstate context but also in the intrastate context in determining the appropriate local rate to apply when transactions, though occurring wholly within a state, have a connection with more than one locality. For example, if a pizza is prepared at a pizza parlor in one county but delivered to a customer in another, a uniform destination sourcing rule that applied on a state-wide basis would require the local pizza parlor to collect tax at the rate in force in the county of delivery. Needless to say, the imposition of a destination sourcing rule on a wide variety of local businesses that are accustomed to collecting taxes at the rate of their local county could create additional administrative costs for such businesses. Moreover, the shift from an origin-based tax to a destination-based tax could also have revenue implications for the counties concerned.

My purpose here is only to describe the issue for the benefit of the Subcommittee and not to address the difficult political issues that are raised by attempting to reconcile

[33] SSUTA § 310(A).

[34] See generally Streamlined Sales Tax Project, Sourcing Issue Paper 6 (Jan. 2002), available at www.streamlinedsalestax.org.

the demands of a streamlined interstate sales tax and the concerns of local taxpayers and their political subdivisions.

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Once again, I thank the Chairman for inviting me to testify before this Subcommittee, and I will be happy to respond to any questions or to provide any other assistance that the Chairman or other Members of the Subcommittee may find helpful.

The Testimony of
Mr. Brian Bieron
Senior Director of Federal Government Relations
eBay Inc.

Before the House Small Business Subcommittee on
Regulatory Reform and Oversight

February 8, 2006

Mr. Chairman and members of the Subcommittee,

My name is Brian Bieron, and I am the Senior Director for Federal Government Relations at eBay Inc. I would like to thank the committee for giving eBay this opportunity to discuss proposals to dramatically expand the authority of states to require out-of-state businesses to collect and remit sales taxes. eBay believes that this is a critically important issue for small business entrepreneurs across America who are increasingly using the Internet to compete in the 21st Century economy.

eBay shares this committee's ongoing interest in the economic success of small business. In the 10 years since our founding, eBay has become a premier destination for small businesses looking for a global marketplace. Small business sellers use eBay to reach customers across America and around the globe, and they care about proposals to expand sales tax collection and remittance duties across the Internet because they could dramatically and negatively impact their bottom line.

About eBay Inc.

I am sure many of you here today are familiar with eBay. Whether it was an experience selling or buying online, or purely "window-shopping," eBay has become the World's Online Marketplace, where anyone can buy or sell practically anything on earth. Started in 1995, eBay has now grown to over 180 million confirmed users worldwide, with more than 78 million items listed on any given day in over 50,000 different categories. Last year, eBay members transacted over $44 billion in annualized gross merchandise sales.

As vast and complex as this on-line marketplace may seem, eBay is actually a very easy and user-friendly website in which buyers and sellers are linked together through a variety of on-line offerings of goods and services ranging from books to automobiles. These buyers and sellers come from all across the United States and around the globe truly making eBay a worldwide marketplace.

Small Business as eBay Sellers

One of the most important developments on the eBay marketplace over the past few years has been the fact that so many small businesses in every State have discovered that the eBay marketplace is a vibrant and valuable place to "do business." As eBay has evolved and grown, it has created new and exciting opportunities for hard working entrepreneurs across America. Currently, over 700,000 U.S. small business people are using eBay today as their primary or a significant secondary marketing channel. We believe that nearly a half-million of these began off eBay, in many cases as brick-and-mortar stores, and they are using the Internet as a new way to compete and grow. Increasingly, Main Street and the Internet are not competing with each other, Main Street small businesses are using the eBay and other Internet channels to compete and survive against global retail companies. The success of these entrepreneurs is creating jobs and opportunities in communities across the nation.

Many small businesses, whether they are working out of their homes, back offices or in storefronts in towns and cities across America, have realized that eBay offers them a way to access an entirely new market of potential customers. They can get "on-line" without overturning their entire way of doing business, and the marginal costs are low.

Small businesspeople that use eBay to do business are just like all small business people everywhere – they are entrepreneurs, risk takers, innovators and dreamers. They need to be resilient, because even successful small business people are not always successful. They are optimists who bank on the future and their ability to thrive in it. But most of all, everyone in this room recognizes that running a small business demands hard work.

We are proud that eBay can help America's small businesspeople reach 180 million potential customers, and provide the tools they need to successfully interact with those customers. That's something that was never possible in the pre-Internet world.

The SSTP

As many of you probably know, the stated goal of the Streamlined Sales Tax Project is to increase state tax revenues by simplifying the underlying sales tax laws enough to lift constitutional restrictions on taxing distant sellers. While true sales tax simplification would have real merit, we believe that the reality behind the SSTP is that it is a long way from true simplification. As currently structured, the "simplified" system would allow over 7,500 different sales tax jurisdictions and potentially 15,000 distinct rates across America. Businesses that use the Internet to reach customers would be required to comply with the collection, payment and tax filing obligations in all 45 states and the District of Columbia that have sales taxes, as well as the many local jurisdictions.

The SSTP – Why Now?

Before we look behind the curtain at the complexities inherent in the SSTP, I believe that is important to look at the economic and business landscape. First, the economy is growing, and federal and state tax revenues are up. In fact, unlike a few years ago, the states are now flush with tax revenues, including sales tax revenue. They are at record levels. While there will always be state and local government officials who will desire more revenue, the SSTP is clearly not driven by state revenue needs.

How about the retail business? The latest figures from the Department of Commerce, available for the 3rd Quarter of 2005, show that total retail sales for the quarter were $957 billion, an 8.5 percent increase over the 3rd Quarter of 2004. This is strong growth.

Quarter	Retail Sales (millions of dollars)		E-commerce as a Percent of Total	Percent Change From Prior Quarter		Percent Change From Same Quarter A Year Ago	
	Total	E-commerce[1]		Total	E-commerce	Total	E-commerce
Adjusted							
3rd quarter 2005(p)	957,864	22,323	2.3	1.8	5.7	8.5	26.7
2nd quarter 2005(r)	941,282	21,112	2.2	2.7	7.0	8.5	25.7
1st quarter 2005	916,768	19,729	2.2	1.4	6.0	7.3	23.3
4th quarter 2004	904,126	18,607	2.1	2.4	5.6	8.3	23.9
3rd quarter 2004(r)	882,822	17,620	2.0	1.7	4.9	6.3	22.2
Not Adjusted							
3rd quarter 2005(p)	962,707	20,817	2.2	1.1	5.1	8.6	26.4
2nd quarter 2005(r)	952,392	19,812	2.1	11.8	3.6	8.1	25.8
1st quarter 2005	852,249	19,124	2.2	-10.5	-11.1	6.3	23.4
4th quarter 2004	952,572	21,519	2.3	7.5	30.6	8.3	24.0
3rd quarter 2004	886,091	16,473	1.9	0.6	4.6	6.3	22.1

(Source: US Census Bureau at http://www.census.gov/mrts/www/ecomm.html)

How about on-line retail compared to traditional off-line retail? Now, make no mistake, Internet retail is growing. It accounted for $22.3 billion in the 3rd Quarter of 2005, up 26.7 percent from the 3rd Quarter of 2004. But, the idea that on-retail is about to overtake off-line retail is simply not backed up by the facts.

Consider this: if you look at how much traditional off-line retail grew, the 3rd Quarter of 2005 increased by $70.3 billion over the same quarter in 2004. On the on-line retail side of the equation, the 3rd Quarter of 2005 increased by $4.7 billion over the same quarter in 2004. The numbers are clear. In terms of the actual retail sales, the total of off-line retail actually grew more than $65 billion more than on-line retail.

How can this be? Well, the fact is that 8 percent growth of over $900 billion in traditional retail dwarfs 26 percent growth of $22.3 billion in on-line retail. We know that on-line retail is a tremendous and growing business, but please don't believe anyone who says that on-line retail is putting traditional retail out of business anytime soon. After all, despite on-line growth, only a little more than two cents of every retail dollar was spent on-line last year.

The Burdens of the SSTP

I believe it is worth spending a moment to recognize the burdens that are implicit in the SSTP. Complying with the SSTP is about more than just calculating how much sales tax is required in each of the 7,500+ taxing jurisdictions. In fact, that might be the easiest part of the burden imposed on small businesses. The reality is that complying with the SSTP would require four phases: Calculation; Collection; Remittance; and Record Keeping.

1. **Calculation –** As I have mentioned, the SSTP allows for over 15,000 sales tax rates in over 7,500 jurisdictions around the country. Today, states change their sales tax rates regularly, and they will be able to change under the SSTP. It will be a full time job just to keep up with the latest state and local changes. In addition, a retailer needs to know the appropriate rate for the appropriate type of product and services. That is enough of a challenge if everything you sell has a UPC bar code. Of course, for many eBay sellers, particularly small businesses, there are many products that are sold that do not have a bar code.

2. **Collection –** It is not the same thing to collect the right tax as it is to simply calculate it. After determining the proper amount of the tax for the particular sale, the seller then must segregate out the proper tax payment so that it can be sent to the right taxing entity. That collection duty is a burden in and of itself.

3. **Remittance –** This is the next part of the tax collection chain, and with the SSTP it is a major challenge. With so many jurisdictions, and different tax collection entities in each state, it is a major challenge to make sure that the right amount is sent to each agency in compliance with the appropriate deadline.

4. **Record Keeping –** A business can't just send a lump-sum check and be done with it, they need to have every sale, and every instance of tax, accounted for so that there is the appropriate data behind every check for every sales tax jurisdiction. It is our understanding that the businesses are liable to be audited once a year by any one state under the SSTP. The advocates express how streamlined this is because it is only one state. But, of course, the taxpayer has no way to know which state will audit in a given year. The reality is that a small business would need to be prepared every year to be audited by every one of the states. That is an unprecedented record keeping requirement.

The SSTP Challenge for Small Online Businesses

As everyone here recognizes, small businesses across the country face numerous challenges. This is just as true for the small businesspeople that use eBay. On a day-to-day basis, our sellers must strive to succeed with a business model that requires new and innovative methods of communications, customer service and delivery over potentially long distances. In short, we believe that throwing a new administrative and tax collection burden onto their businesses will hurt their ability to succeed.

The fact that this is unquestionably too much for any small business to handle has essentially been admitted by the SSTP advocates from the beginning of the project. SSTP supporters know that a small business could never comply with calculation, collection, remittance and record-keeping on its own, so they presume that technology firms – certified service providers (CSPs) – will do the job for them.

I believe this is a critical point for everyone here to walk away with: SSTP supporters admit that their system won't work unless outside technology companies are involved. If small businesses can't (or don't) use an outside technology, then under the SSTP they basically need to get off the Internet. We think that is the wrong message to be sending small on-line businesses that are contributing so much to our nation's economic growth.

The SSTP advocates claim that they will cover the cost of the CSPs to help small businesses comply with a new complicated tax regime, but if you look at the fine print, there are glaring weaknesses. First, the level of compensation is unrealistically low. The states are talking about compensation on the range of 3 percent of the tax collected. Assuming a 7% sales tax rate, that works out to about 0.21 percent, one-fifth of one percent, of the price of the product. This level of long-term compensation is far below what service providers in the financial services field normally charge for this kind of complicated long-term service. It's not hard to figure who will be left holding the bag for additional costs: it won't be the state or the CSP, it will be the small business person.

In addition, the SSTP advocates ignore the range of costs a small business is likely to face in order to make its computer system work with the CSP solution – these are integration, hardware and training costs. It is worth noting that some CSPs have said that they believe these "integration costs" will be their main line of business.

Finally, at the level of compensation being discussed, the level of service that small business will receive will likely be low. And one-size-fits-all is the opposite of the special needs of small businesses.

This compensation scheme has all the attributes of a classic bait-and-switch, or a "gotcha." The legal burdens will be placed on small businesses, and over time the costs imposed by the service providers go up. The states will refuse to pay – they have no incentive to foot the bill – and the costs are shifted to the small businesses.

Solution – Small Business Exemption

As I have mentioned, the Internet is increasingly an important technology tool helping America's small business entrepreneurs survive and thrive in a dynamic and challenging global economy. We believe that changing federal law to impose a major new tax collection burden on them will hurt their chances for success. We think it would be bad for them, and we think it would be bad for the overall U.S. economy, killing jobs and hurting entrepreneurs in communities across the country.

We believe that federal government policies to promote the growth and success of small businesses help the overall U.S. economy by promoting one of the primary engines of growth, innovation and job creation. That includes federal government policies to exempt small businesses from burdensome regulations and government mandates. With over 700,000 Americans using the eBay marketplace to help run successful small businesses, we believe that a workable and robust exemption for small business is an indispensable component of any Internet sales tax plan.

As you may know, SSTP legislation introduced in the House and Senate in recent Congresses included a "small business exemption." Unfortunately, bills in recent Congresses fell short of the mark, setting the exemption at a level that is arbitrary and far below established federal small business size standards. This is also the case with S. 2152 recently introduced by Senator Mike Enzi. eBay's view has been, and will continue to be, that if any SSTP is to be considered, the small business exemption must be strengthened so that it is reflective of today's thriving, Internet-enabled small business community.

Such an effort has been undertaken by Senator Byron Dorgan, a long-time advocate of the SSTP concept. His small business exemption proposal, included in S. 2153, is built on a process that eBay believes is fair and reasonable, and will protect small businesses.

The Small Business Administration is the federal agency with the mission to help promote America's small businesses and entrepreneurs, and the experience to do this job right. The Dorgan proposal would require the SBA to undertake a rule making to determine how the SSTP small business exemption would be structured and which businesses will be covered. The Congress would retain its critical role and be required to approve the SBA recommendation before the SSTP mandates went into effect. eBay believes this is one acceptable formulation for a small business exemption in any legislation that would implement the SSTP.

Conclusion

While this can be a somewhat complex issue, some things are clear:

1. The U.S. economy is strong and growing, and small business entrepreneurs and innovators, using new Internet technologies, are one of the most important engines of growth and job creation.

2. State tax revenues are up and at record levels.

3. Off-line and on-line retail are both growing, but there's no risk of on-line sales supplanting off-line retail anytime soon.

4. The SSTP is anything but streamlined. It is a very complex system and small businesses using the Internet could never comply without the paid help of technology service providers. The states claim that they will pay those providers, but the amount promised is likely to prove woefully insufficient and would put small business at the mercy of a very unreliable system.

5. A small business exemption to avoid placing a new and burdensome regulatory mandate on small businesses is entirely in keeping with federal precedents and is good policy and ought to be a prominent feature of any SSTP legislation.

And,

6. The level of an SSTP small business exemption should be based on the existing federal standards and the expertise of the federal agency empowered to protect and promote small businesses.

eBay will continue to work hand-in-hand with our army of small business entrepreneurs to ensure that if Congress acts to authorize the states to require out-of-state businesses to collect and remit sales taxes, it includes a small business exemption that is fair and reasonable and that protects this important engine of growth in our economy.

Thank you, and I am happy to answer questions.

Testimony of

Paul Misener
Vice President, Global Public Policy
Amazon.com

Before the

Subcommittee on Regulatory Reform and Oversight
Committee on Small Business
United States House of Representatives

Hearing on

"The Internet Sales Tax: Headaches for Small Business?"

February 8, 2006

Good morning, Chairman Akin, Representative Bordallo, and members of the Subcommittee. My name is Paul Misener, and I am Amazon.com's Vice President for Global Public Policy. Thank you for inviting me to testify on this important topic. I ask that my written statement be included in the record of this hearing.

Mr. Chairman, the Internet is a great enabler of small business. In its early days, the Internet was a haven for innovative, technically-savvy small businesses, and today it has become an important channel for all kinds of small retail businesses, not just those with technical expertise. The issue of Internet (or, more precisely, interstate or "remote") sales taxation presents three key public policy questions. With my time this morning, I hope to provide some helpful thoughts on each of these questions.

BRIEF HISTORY AND STATUS OF E-COMMERCE

Before I get to these policy questions, however, I think it important to note briefly the history and status of e-commerce. A decade ago, Amazon.com, eBay, Yahoo!, and other current household names were obscure small businesses, and Google wasn't even yet formed. These small businesses had something in common: technical skills that enabled them to provide content-based services by using the Internet's physical infrastructure and a brand new software application called the World Wide Web. It's no accident that the founders of these companies were engineers. They not only needed a vision, they had to take a complex foundation – the Web – and turn it into something useful to non-technical people. These small business owners overcame the technical challenges of putting up and running a website, attracting consumer traffic to the site and, with the help of electronic payment processors, facilitating retail transactions. At the time, none of this was easy.

But, as these small businesses grew into the big businesses they are today, they vastly simplified the task of getting a small retail business online. Indeed, these companies and others now provide services so that today's small businesses don't have to be technically savvy to make good use of the Internet. With the help of big service providers like Amazon.com, eBay, Yahoo!, Microsoft, Google, and AOL, today's small businesses online need not understand how the underlying technology works nor even directly deal with it.

Several different e-commerce business models now coexist and vigorously compete on the Web. One model is traditional retail; most often by "clicks and mortar" companies that have both a physical store and a retail website, but also by a few

remaining "pure play" online traditional retailers, like Amazon.com's core business. Another model is "platform" retail, whereby large companies such as Amazon.com, eBay, and Microsoft's MSN provide e-commerce services to other companies, both large and small. A third important business model is "search" retail, whereby companies like Google (particularly through its Froogle shopping service) and AOL provide online paths and preferred access to thousands of retail businesses.

Incidentally, my friends at eBay deserve considerable credit for their success with the platform model. Many people only think of eBay as an auction services provider. Although it's true that no other online auction business comes close to their size and market reach, the genius of the eBay business model was not just in providing variable, auction-style pricing. Rather, it also was smart to provide a package of services to businesses that want to sell online without establishing their own website. eBay sells to such businesses, most of which individually are small, marketing, inventory management, sales tracking, reporting, and other services, and annually has tens of billions of dollars of sales transactions run through their website.

INTERNET SALES TAX COLLECTION

The Internet sales tax collection issue presents policymakers three key questions. First, as a matter of macro public policy, should Congress authorize the states to require remote sellers to collect sales tax? Second, if so, have the states adequately simplified their tax codes so that there no longer would be an unconstitutional administrative burden on interstate commerce? And, third, is there any justification for requiring only some classes of sellers to collect, but not others?

Terminology and Current Law

I will spend the rest of my testimony on these three questions but, before I do, please allow me to clarify some terminology and describe the law as it stands today. As many of you know, the term "Internet sales tax" is a bit of a misnomer. The essential concept is not "Internet" so much as it is "interstate." The issues at hand arise when a buyer is in one state and the seller is in another. Even then, the key sales tax policy questions are reached only if the seller lacks sufficient contacts, called "nexus," in the buyer's state. A transaction under these conditions is known as a remote sale. If the seller has sales tax nexus in the buyer's state, then the seller already must collect tax. If, however, the seller lacks nexus in the buyer's state (*i.e.*, in a "remote" sale), the seller today cannot be obligated to collect sales tax. This is true whether the sale is made over the Internet, by telephone, or through the mail. (In my testimony today, I use the terms "remote," "interstate," and "out-of-state" interchangeably, with the understanding that in each case the seller lacks tax nexus in the buyer's state.)

Fundamental rights embodied in the Constitution give rise to this bifurcated treatment of tax collection. The Supreme Court twice has held that, under the Commerce Clause, it would be unconstitutionally burdensome to allow a state to require out-of-state sellers to collect tax. The Court said that this burden arises out of the fact that the states' current sales tax codes are extremely complex. There are thousands of taxing jurisdictions, often with poorly defined geographic boundaries, and each with its own tax rates and arcane rules. The Court held that it would be unconstitutional to require remote sellers to comply with these complex codes. But, the Court also made clear that

Congress could, at some point in the future, determine that the states' sales tax codes had been sufficiently simplified, and authorize states to require interstate sellers to collect.

Should Interstate Sellers Collect?

The first public policy question presented by these circumstances is whether the states *should* be authorized to require remote sellers to collect tax. One component of this question is whether such sales tax collection responsibilities should be borne by private concerns. Every state that has a sales tax also has what is known as a "use tax," which also applies to retail transactions, but rather than being collected by the seller, a use tax is owed by the buyer. The current interstate sales transactions often thought to be "not taxed" are, in reality, taxed, but the tax is simply not collected by the seller. Thus, one way for the states to obtain tax revenue on remote sales would be for them to improve use tax compliance.

Given the difficulties of use tax collection, however, the states have looked to Congress for authority to require out-of-state sellers to collect for them. This raises the more fundamental question of whether, as a matter of public policy, this tax should be made easier to collect. Many have opposed collection outright, saying that, as a matter of public policy, Internet sales should be untaxed, or perhaps *less* taxed. Perhaps there are environmental, social efficiency, public infrastructure utilization, and other reasons to favor Internet sales over brick and mortar sales. By conserving fuel, saving time, and using fewer public roads and other local services, e-commerce arguably should remain under-taxed. For these reasons, it has been said, Internet buyers should be protected from the price increases that tax collection by sellers would cause.

Amazon.com does not have a position on this high level policy question; there are sound arguments on both sides. We concluded almost six years ago, however, that it certainly would be reasonable for policymakers to decide that the tax should be collected by sellers. We also concluded that Amazon would not be hurt by a sales tax collection requirement, so long as the administrative burdens of collection were eliminated and that our online competitors also would be required to collect. Put another way, we've known all along that, because of the inherent consumer benefits of e-commerce as well as our confidence in our commitment to serve our customers, we don't need a sales tax price advantage to do very well with respect to our competition.

After reaching these conclusions, we decided to help the states in their efforts to improve their sales tax codes, and we were appointed as a private sector representative to the Streamlined Sales Tax Project (the "SSTP"). To my knowledge, we are the only major "pure play" e-commerce company to have cooperated with the states in this way.

Have State Tax Codes Been Adequately Simplified?

The SSTP's work raises the second key question for policymakers: if it makes sense as a matter of public policy to allow states to require remote sellers to collect, have the states adequately simplified their tax codes so that there no longer would be an unconstitutional administrative burden on interstate commerce?

There is not sufficient time in this hearing to describe all the challenges, proposals, and solutions the states have considered in the SSTP over the past several years. Nor is it possible to describe all the tax code changes agreed in the resulting Streamlined Sales and Use Tax Agreement (the "SSUTA"), or even to give a complete

picture of how many states have fully adopted the provisions of this pact. Suffice it to say that, so far, the states have made significant progress, but that most states (including, *e.g.,* California) and most of the population of the country are not covered by this work.

Moreover, there are some key shortcomings to the substantive tax simplifications required in the SSUTA. These substantive shortcomings have been recognized by many people, and have been addressed in federal bills, most recently in the two bills introduced at the end of last year in the Senate. Both of these bills would require the states to adopt additional improvements beyond the SSUTA to cover the shortcomings.

So, the more precise second question presented to policymakers is whether the improvements included in the SSUTA, as augmented by the additional requirements in the current federal bills, are sufficient to remove the longstanding unconstitutional burdens found by the Supreme Court. Although Amazon.com believes that even more simplifications could and should be made, we think the current Senate bills, if applied fairly, would require adequate simplification, at least for sellers online or using other electronic transaction services. In other words, we are certain that companies facilitating retail transactions online or otherwise electronically could readily comply with the sales tax collection system if it were simplified as required under the current Senate bills and, thus, there would not be an unconstitutional burden of collection on sellers using these companies' services.

Should Any Class of Sellers be Exempt?

This brings us to the third and last key question: is there any justification for requiring only some classes of sellers to collect, but not others? It has been suggested,

for example, that small out-of-state businesses be given a blanket exemption from tax collection requirements.

At Amazon.com, we are not particularly familiar with transactions involving paper money or substitutes like personal checks or travelers checks, and there may be good reasons to exempt truly small interstate sellers using such instruments. But we are very familiar with electronic payment systems, especially those operating online. With these systems, transactions are processed by a relatively small number of very large companies that can and will provide tax collection services if they are required directly by law or by market forces. It is inconceivable, given the technical sophistication of online seller service providers and electronic payment mechanisms, that Amazon.com could figure out and comply with the newly-simplified tax collection system, but that other billion-dollar companies providing these services could not.

So what does this mean for small business? Good news. The large companies that already provide online and other electronic transaction services to small businesses certainly also can provide sales tax collection services, either by themselves or with the help of specialized service providers like Avalara. Put another way, given that small businesses operating online or using electronic payment mechanisms already rely on huge businesses for transaction services, it is crystal clear that they also could rely on these same huge businesses to meet a new sales tax collection requirement. So, if the aforementioned policy and factual conditions are met, it would make perfect sense to require all retail businesses, large and small, to collect sales tax, at least for transactions online or using other electronic payment mechanisms.

To be sure, no one expects truly small businesses to do the work of sales tax collection alone, but that doesn't mean they shouldn't be required to do it at all. By analogy, we require small businesspersons to sign their legal documents in ink, but we don't expect them to make their own ball point pens. Amazon.com will offer sales tax collection services to our small business seller customers, and I am sure that our online competitors also can and will, unless they can take advantage of some legal loophole. Thus, when small businesses using online or other electronic payment services are required to collect, their service providers – very big companies – will do it for them.

Of course, this discussion so far has been limited to small businesses conducting interstate sales. What about small, "Main Street" businesses selling locally? From the very start of our company, we said that online retail would never entirely supplant physical stores, and we've been proven right. Even after a decade of e-commerce, and despite the wild predictions of the late 1990s, still over 90% of retail sales are *offline*. There are good reasons, of course, including that physical stores provide consumers instant delivery, inform our senses of touch and smell, provide opportunities for socializing, and help bind together our local communities. So, as we consider the implications of tax policy, it is particularly important to consider the effects on Main Street small business.

Small Main Street businesses already collect sales taxes and, thus, have both the administrative burden of tax collection and the higher prices caused by it. If out-of-state small businesses would not have to collect, then their Main Street brethren would be saddled with a competitive disadvantage, both as to burden and price. Although, before state sales tax codes are simplified, the burden of collection is lower for Main Street

sellers than it would be for those selling interstate, this factor is eliminated when, under the simplified codes, big companies collect on small remote sellers' behalf. Then, the only difference would be a price advantage for small interstate business over small Main Street business. Hopefully, policymakers never would conclude that this disparity would be fair to Main Street small businesses.

More generally, the twin policy purposes of a mandatory remote sales tax collection regime would be (1) to "level the playing field," that is, take away the current price advantage of out-of-state sellers so that local sellers, including small businesses, would no longer be disadvantaged; and (2) to increase state sales tax collections without the states themselves having to beef up use tax compliance. But, if some large class of interstate sellers were exempted from a new collection requirement, both of these policy purposes would be thwarted. Under one proposal, sellers with less than $5 million in annual gross remote taxable sales would be exempt from collection requirements. But roughly half of e-commerce is conducted by such companies. If such an exemption were adopted, small Main Street sellers would continue to face the price disadvantage of having to collect sales tax while their out-of-state competitors did not, and the states would end up foregoing roughly half of the sales tax revenue otherwise available. Even if the threshold were reduced to $100,000, roughly a quarter of online sales would enjoy a significant price advantage over sales by small Main Street retailers, and the states would be denied the same portion of the available revenue.

Importantly, there would be no good reason for failing these two essential policy purposes of mandatory sales tax collection because, as described before, small businesses

online or using other electronic payment mechanisms could just as easily collect the sales tax as their Main Street counterparts who already do.

CONCLUSION

In conclusion, Mr. Chairman, the Internet is a great enabler of small business, not just for companies like Amazon.com, which only a decade ago was a small business itself, but also for today's small sellers, which need not be technically savvy to participate fully in e-commerce. Large online companies and electronic payment systems already provide myriad transactional services to small businesses. If Congress eventually decides to allow states to require out-of-state sellers to collect sales tax, these large companies will be completely capable of providing the necessary tax collection services to small businesses. Thus, to answer the question posed in the title of this hearing, if the states' sales tax codes are truly simplified and collection requirements are uniformly applied, Internet sales tax will not cause headaches for small businesses online, and actually will cure the preexisting disadvantages to small businesses offline.

Thank you again for inviting me to testify, I look forward to your questions.

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The Testimony of
Mr. Ernest Perry
Owner, Treasures Recycled

Before the House Small Business Subcommittee on
Regulatory Reform and Oversight

February 8, 2006

Mr. Chairman and members of the Subcommittee,

My name is Ernest Perry and I have been a small business owner in North Carolina for more than 25 years. I started in the jewelry business in 1978, managing a store for the retail chain Jewel Box Stores Corporation in Greensboro and learned as much as possible about running a business and the jewelry industry. Always wanting to go into business for myself, I had also become a licensed auctioneer and began offering my services to non-profits where I helped sell donated estate and antique jewelry to raise funds for their organizations. I later opened my own store called Perry's Jewelry Emporium, specializing in antique and estate jewelry in 1980.

As the price of gold and silver went up, so did our business sales. We were so successful that we opened multiple "Perry's" stores throughout North Carolina. Also at that time, I had a partnership with Sears Department Stores. I was the franchisee for over 45 Sears stores and essentially operated the jewelry departments for each of them.

However, I was growing weary of the travel and by 1995, I wanted to consolidate my stores and simplify my business operations. I chose the South Park location, which is the current site for the one "Perry" store today.

As I was undergoing a remodeling project for the store, a woman who was helping me with the remodeling, introduced me to eBay. She talked about the ease of conducting business on eBay and of the many success stories – and I was immediately interested. While my storefront was continuing to do well, I was intrigued about having an online presence for my jewelry collection and being able to reach a much broader customer base without the earlier stress of travel. It was then that I recognized eBay's marketing potential and I developed the concept for Treasures Recycled.

I started Treasures Recycled in 2002 as a "drop off" location to accommodate the growing number of people turning to me to handle the resale of their personal jewelry as well as overstocked items from my storefront, Perry's. People bring me the items they would like me to sell for them and I turn to eBay to get the job done. This approach has allowed me to sell items to people in every state and other countries.

My sales from my eBay business continue to increase each year, approximately generating $1 million in annual sales. With just the online store, I have five employees and offer full benefits.

Implications of Changing Sales Tax Laws

Much of the appeal of eBay is that it allows an entrepreneur to develop his or her own Internet-based business, giving someone the ability to reach more potential customers than they ever could on their own. And it is easy enough for a busy small business person to use.

Through my experiences with eBay, I have met many people who have started their own business. I believe that the Internet attracts many people who otherwise may not be inclined to be a small business owner. In my personal case, I've been fortunate enough to have both a brick and mortar store and an online store. Because of this, I can speak as both an on-line and store-front small business owner.

I understand the sales tax issue and the "fairness" question it raises for online businesses that do not collect and remit sales taxes for sales to out-of-state customers. Be assured, I do collect and remit taxes for Perry's according to the tax code in North Carolina. There is single sales tax rate, and a single tax authority to remit the taxes to.

Legally, I am not required to collect and remit sales taxes for all the customers outside of North Carolina who visit Treasures Recycled, my on line presence. There is really no doubt in my mind regarding the complexity of what would be required to collect and remit taxes on the thousands of different tax jurisdictions around the country. My understanding is that there are more than 7,600 jurisdictions nationwide. There would undoubtedly be new costs imposed on my online business that would be very hard, if not impossible, to deal with as a small business owner.

While some people claim that there are big technology companies that would be happy to step in and take care of the tax collection and remittance job, I think that the SSTP process is filled with risk for small business owners. There are significant potential costs that I can see for any complicated sales tax plan, especially when a small business is forced to contract the job out to one of a handful of technology companies. Computer system upgrades or changes, training employees on new systems, and the possibility that the off-the-shelf solution doesn't work right, are all expensive risks. And finally, what if a couple of years down the road the fees go up? There is no going back and small businesses will be the losers.

There is no question that it has not been easy to be a small business retailer over the last few decades. The world has changed so much. The Internet is obviously one big change, and it's been both a challenge and an opportunity in the retail business.

But small retailers have also had to adapt and adjust to mega retailers like WalMart and the Big Box Stores who have used all kinds of technologies to revolutionize their global retail businesses. And in my experience, the Internet has actually empowered small business people to deal with those dramatic changes. I believe there is no question that the Internet offers a small business more opportunity than risk. And I believe that Congress changing the status quo on state sales tax laws would make it harder in the long-term for small businesses and entrepreneurs to succeed in the face of those challenges.

Again, thank you for inviting me to speak to this committee today.

February 2, 2006

Streamlined Sales Tax Initiative and Small Business

Streamlined Sales Tax (SST) is a collective effort by member states to collect taxes that are owed to them for purchases made by people or companies residing in their individual state. Currently, if sales tax is not collected by a seller at the point of sale, the individual or small business that purchased the goods or services is expected to self assess these taxes - accruing, reporting and paying what is commonly referred to as Consumer Use Tax. This method is burdensome, unreasonable and ultimately results in billions of lost tax revenue for the states. From an efficiency perspective, the best way of collecting these taxes is at the point of sale, making it far more logical to have the seller assess, report, and remit the tax. Historically, however, the large number of taxing jurisdictions and the complex rules associated have made it impossibly burdensome for the small business "seller" who does not have, nor can he/she afford, the specialized resources required to manage the sales and use tax process. New technological developments and capability have converged with the Streamlined Sales Tax Initiative, engendering an internet based service model that allows for the efficient calculation and collection of taxes at the point of sale and allows small businesses to participate in the benefits of low cost and near zero burden tax compliance.

Should Small Businesses be exempt from collecting taxes?
This is a political issue that Avalara, Inc. is neither for nor against. We serve small and mid sized businesses and therefore believe we should not take a stance on this issue. The real question is how tax should be collected from purchasers who buy products or services from a remote seller. According to statutes in the majority of states, tax is required to be paid on these transactions. However, we know that for various reasons, people making these purchases are not paying the tax unless it is collected at the time of sale. So in effect, when a person buys a good or service from one remote company (who has nexus), they pay the tax at the time of the transaction, and if they purchase the same good or service from another remote company (who does not have nexus) they do not. Shouldn't we have a tax system that treats all purchasers the same and enforces the collection of tax no matter from whom the purchaser decides to source the product or service? This works in theory, but there are some unanswered questions and issues in so much as the businesses faced with assessing and collecting the taxes do not have the resources to do so.

What are the hurdles faced by Small Business in collecting taxes?
Avalara works with small and mid sized businesses ("SMB") every day. We work with partners in the accounting software reseller channels to deliver our AvaTax service to customers with the goal of "Making Sales Tax Less Taxing". Our mission is to transform the tax process for our customers by creating cost-effective state-of-the-art solutions. We do so through integrated software that provides transparent transactions, accurate tax compliance, painless administration and effortless reporting.

SMBs, especially small businesses, do not have employees with the necessary expertise to manage the sales tax process and the thousands of associated jurisdictions, rates, rules, and filings. They are focused on providing goods and/or services to their market, not in complying with complex statutes that redirects time and effort away from achieving their business goals and objectives. Companies, such as Avalara, have emerged to provide a full Sales Tax Management Service (STMS) replacing the historically expensive software installed on site requiring expensive consulting resources to implement properly. With STMS, tax compliance is affordable for small businesses.

The vision of STMS is to provide a compliance service with very little administrative burden and virtually no cost - allowing the small business to focus on the reason they are in business not figuring out sales tax compliance. Avalara and other companies have taken this vision and

invested significant resources in realizing it. We have automated compliance and made it easy to assess and collect sales taxes.

With STMS, a small business owner can sign up and gain access to these benefits without causing disruption to their business operations. Avalara, as well as other CSP candidates, have pre-built interfaces to popular accounting, ERP, eCommerce, and payment gateway systems. These systems are a growing number of packages that are commonly used in the market place. They include products from Intuit (QuickBooks), Sage (MAS 90, MAS 200, and MAS 500), Microsoft (GreatPlains, Microsoft Small Business Financials, and Navision), Epicor, Open Systems, Nodus Technologies, and others. We have a growing number of independent development companies and software publishers that have created interfaces to other packages and technology platforms. As people become more aware of SST and the needs of small business, these interfaces will continue to grow and will be available to more and more business owners.

What are the costs of compliance?
Sales tax compliance involves research in understanding the statutes, compiling the rates associated with the thousands of taxing jurisdictions, associating the rates with boundary data so the rates are applied correctly, research in product and entity/use exemptions and exceptions and the associated rules in applying the exceptions such as caps and thresholds, timing and calculations of prepayments, tax returns, remittance, internal and external audit, and interest and penalties due to mistakes.

In working with small businesses, we know they typically do not understand all the details around compliance and do not have a handle on the costs to their business. They do know it is overwhelming and a drain away from the very reason why the business was started in the first place. Compliance to sales tax law for these businesses is costly. The changes introduced by SST and standardized statutes among member states, although necessary and a benefit in the long run, introduce uncertainty and an administrative burden in the short term. However, with STMS made possible by the advancement of technology is available on the market place today and drastically reduces compliance costs.

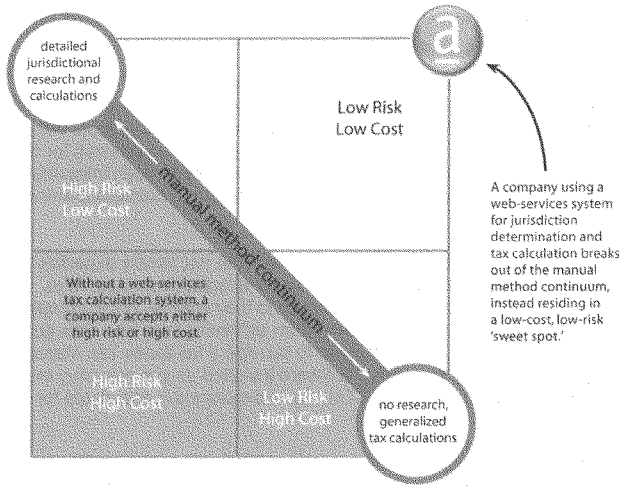

Figure 1: Cost of Compliance Quadrant

How do we collect taxes on purchases owed to the states and limit or eliminate the burden on small business?
America understands the importance of small business to our continued growth and prosperity. Small business already faces many challenges in serving their marketplace even without considering the burden of tax compliance. STMS provides the vision of reducing administrative burden through technology and compliance services. These services eliminate the need for small businesses to hire specialized tax resources, not only through full compliance software and services, but the ability for small business to use the accounting and eCommerce packages they use today to plug into the compliance services. In partnering with service providers, small business will no longer have to worry about the amount of tax collected, the allocation of time and resources to fill out tax returns, prepare for a tax audit, or worry if they will be found out of compliance and required to pay penalties and interest. With STMS, the effort and worry is shifted from the small business to the service provider.

How should Certified Service Providers be compensated?
Certified Service Providers are responsible for calculating, collecting, and reporting the correct amount of tax for a given transaction. In determining how to compensate CSP's, we need to consider not only the costs of compliance, but the size of business, complexity and diversity of products and services offered, the size and number of transactions, and whether or not the transactions are taxable or exempt.

CSP compensation should be designed to provide incentives to sign up sellers in all business and industry groups. Depending on how the compensation is structured will determine the business and industry groups the CSP's will target. For example, if CSP compensation is based on tax revenue collected, CSP's will make the most money on companies with low volume, high cost items and will therefore focus on signing those sellers up under Streamlined. If compensation excludes non-taxable transactions, food, and to a lesser degree clothing and medical equipment industries, they will be excluded as well as companies who sell primarily to government, school, and non-profit organizations. If compensation uses a single rate, whether that is transaction or tax revenue based, big business will benefit at the cost of small business because the margins will be higher.

Avalara will work with whatever compensation model is provided. We do believe, depending on the compensation model, there will be winners and losers in the business community. To avoid having winners and losers, we believe a tiered pricing model based on transaction volume more closely represents the cost structure of a CSP. Additional consideration could be added for the type of industry. Transactions should not be limited to taxable transactions. Compensation should apply to both nexus and non-nexus transactions. See table below.

QuickBooks

Transactions per Year	Activation Fee	Annual Contract Service Fee*		Additional Transactions
		Monthly Payment Plan	Annual Pre-payment	
0 - 719	$49.95	$ 9.95 + .65/transaction	$113.43	-
720	$89.95	$29.95	$341.43	$0.60
1440	$149.95	$49.95	$569.43	$0.55
3000	$295.95	$99.95	$1,139.43	$0.50
7200	$795.95	$219.95	$2,507.43	$0.40
14,400	$1,495.95	$349.95	$3,989.43	$0.35
24,000	$1,995.95	$499.95	$5,699.43	$0.30

* Annual contract. Transactions are reconciled annually with changes adjusted accordingly.

Figure 2: Published QuickBooks Base Prices for AvaTax

The second choice in a compensation model is based on tax revenue collected. This method is preferable to the states since they can easily estimate their costs and audit CSP compensation without accessing CSP systems. However, it is more difficult to include compensation for non-taxable transactions and it is skewed to benefit businesses with low volume, high value transactions. Additional considerations for per transaction compensation or compensation based on invoice amount for non-taxable transactions would need to be included.

Some states have said they don't want to pay for non-taxable or exempt transactions. The cost of compliance for a company that sells non-taxable goods or services and/or sells to exempt individuals or organizations is more than the cost for companies selling taxable goods and/or services to organizations that don't qualify for exemptions. The research and configuration of the goods and services rules as well as the maintenance of the exemption certificates is costly. There is also a significant benefit to the states by ensuring these companies remain in compliance and in eliminating the need to audit these companies individually – the states can audit these companies collectively through the service providers.

SST member states are divided on the issue of compensating CSP's for sellers with existing nexus. The changes made to state statutes to conform to the Streamlined Sales and Use Tax Agreement (SSUTA) has caused uncertainty and confusion and an increased administrative burden for small businesses. A STMS eliminates the confusion and burden.

If policy makers want to exclude specific industries, a compensation model can be utilized to this end. To exclude food, clothing, and medical equipment industries, compensation should exclude non-taxable transactions. To exclude government contractors, companies who specialize in providing goods or services to schools or non-profit organizations, or wholesalers, again, compensation should exclude non-taxable transactions. To exclude small businesses, either have a single tier, or a tiered structure that pays CSP's less for businesses that fall into the lower tiers. To exclude larger businesses, reduce the rate in the higher tiers. Finally, to exclude main street merchants and small businesses who have limited geographic reach, exclude compensation for those sellers with existing nexus.

Conclusion

The question of whether or not small businesses should be exempt from collecting taxes is a political issue outside the scope of Avalara's control. The real question is whether or not a solution exists to enable easy sales tax collection for all business, regardless of size.

A simple, easy to use system that overcomes the myriad of complex decisions for any company making an effort to be compliant is a good thing. Not only does it enable all businesses to be treated equally it doesn't create a penalty for success once an organization surpasses an artificial "Very Small Business" threshold. A side effect of this universal solution is that buyers will no longer favor one seller over the other based on specific jurisdictional preferences.

A Sales Tax Management Service (STMS) can easily automate the calculation, reporting and remittance of Sales Tax for any business. However, it is especially effective to reduce the burden of compliance for Small Businesses. The convergence of Web Based Tax Management Services and Secure Internet Connectivity has enabled low cost compliance for even the smallest companies due to technological advances that have dramatically matured in the last 4 years.

STMS has changed the landscape of sales tax compliance and bring ubiquitous solutions to companies of all sizes. SMTS makes it possible to collect the taxes and fund the public services needed by constituents in the member states where they reside, unlike any other alternative and for even the smallest companies in the United States.

Rory Rawlings
Founder and Chief Tax Automation Officer
Avalara, Inc.

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