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MARKETPLACE EQUITY ACT OF 2011

HEARING

BEFORE THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

SECOND SESSION

ON

H.R. 3179

JULY 24, 2012

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MARKETPLACE EQUITY ACT OF 2011

TUESDAY, JULY 24, 2012

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

The Committee met, pursuant to call, at 10:06 a.m., in room 2141, Rayburn House Office Building, the Honorable Lamar Smith (Chairman of the Committee) presiding.

Present: Representatives Smith, Coble, Gallegly, Goodlatte, Chabot, Pence, Forbes, King, Franks, Jordan, Poe, Griffin, Marino, Adams, Amodei, Conyers, Scott, Watt, Lofgren, Jackson Lee, Cohen, Johnson, Chu, Deutch, Sánchez, and Polis.

Staff Present: (Majority) Richard Hertling, Staff Director and Chief Counsel; Travis Norton, Counsel; David Lazar, Clerk; (Minority) Perry Apelbaum, Staff Director and Chief Counsel; Danielle Brown, Counsel; and Norberto Salinas, Counsel.

Mr. SMITH. The Judiciary Committee will come to order. Without objection, the Chair is authorized to declare recesses of the Committee at anytime. We welcome our witnesses, and we welcome the large amount of interest today in the subject as well. I am going to recognize myself for an opening statement and then the Ranking Member.

Last November, the Judiciary Committee held a hearing to explore whether Congress should enable States to collect sales taxes from retailers who lack a physical presence in the State. Today we will consider a legislative proposal authored by our colleagues Congressman Steve Womack of Arkansas and Congresswoman Jackie Speier of California. Their bill, H.R. 3179, the "Marketplace Equity Act of 2011," has bipartisan support from Members both on and off this Committee.

In the 1992 case *Quill v. North Dakota*, the Supreme Court held that under the Dormant Commerce Clause, a State may not compel a retailer to collect and remit the State's sales tax if the retailer lacks a physical presence in the State. In the Supreme Court's view, to force a retailer to collect and remit taxes to more than 9,000 State, county, and local taxing jurisdictions throughout the country places a serious burden on the retailer's ability to sell in interstate commerce. *Quill*'s bright-line "physical presence" rule for tax collection makes sense for small businesses that cannot afford to track and comply with 9,000 different tax codes as a cost of doing business throughout the country.

The Constitution does not allow one State to reach into the pockets of another State's retailers to exact taxation without represen-

tation. But brick-and-mortar retailers claim that the physical presence rule creates an unlevel playing field between them and their online retailer counterparts. Online retailers, who maintain a very limited physical presence and use common carriers to fill orders, enjoy a competitive advantage over traditional retailers. This is because most States cannot compel the online retailer to collect and remit its sales tax. Neighborhood brick and mortar stores, meanwhile, must collect and remit taxes on all purchases.

Moreover, State and local governments view the taxes they cannot collect on most online sales as lost revenue. It is true that online consumers owe a use tax to the State in which they reside, but data show that use taxes are easily avoided, rarely paid, and difficult to enforce.

The Court's decision in *Quill* was based on the observation that compliance with numerous taxing jurisdictions' laws would be burdensome and confusing. The Constitution does not require a physical presence standard as a tax collection criterion. Congress may pass legislation that uses a different standard under its power to regulate interstate commerce. The Marketplace Equity Act replaces the physical presence requirement with a requirement that State and local governments significantly simplify their tax policies if they want to collect sales taxes from out-of-State retailers.

It also contains an exception from the tax collection duty for small sellers. Any bill to enable sales tax collection from remote vendors should contain a robust small seller exception. This way America's job-creating small businesses do not become mere tax collection agencies for those 45 States with a sales tax.

While today's hearing is on the Marketplace Equity Act, at least two other similar bills have been introduced this Congress: one by Senators Enzi, Durbin, and Alexander called the Marketplace Fairness Act, and one by the Ranking Member of this Committee, Mr. Conyers, called the Main Street Fairness Act.

We look forward to hearing from our witnesses today and appreciate their testifying, and the Ranking Member, the gentleman from Michigan, Mr. Conyers, is recognized for his opening statement.

[The bill, H.R. 3179, follows:]

I

112TH CONGRESS
1ST SESSION

H. R. 3179

To improve the States' rights to enforce the collection of State sales and use tax laws, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

OCTOBER 13, 2011

Mr. WOMACK (for himself, Ms. SPEIER, Mr. POE of Texas, Mr. DIAZ-BALART, Mr. ROSS of Florida, Mrs. MALONEY, Mr. WELCH, Ms. MCCOLLUM, Mr. DUNCAN of Tennessee, and Mr. MILLER of North Carolina) introduced the following bill; which was referred to the Committee on the Judiciary

---

A BILL

To improve the States' rights to enforce the collection of State sales and use tax laws, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Marketplace Equity Act of 2011".

SEC. 2. AUTHORIZATION FOR STATES TO REQUIRE COLLECTION OF SALES AND USE TAXES.

(a) GRANT OF AUTHORITY.—Notwithstanding any other provision of law, a State electing, individually or

through an agreement with one or more of the several States, to satisfy the requirements of subsection (b) is authorized to require all sellers not qualifying for the small seller exception to collect and remit sales and use taxes with respect to remote sales into the State without regard to the location of the seller.

(b) REQUIREMENTS FOR AUTHORITY.—The authorization provided under paragraph (1) shall be granted once the State implements a simplified system for administration of sales and use tax collection with respect to remote sellers, which includes the following minimum requirements:

(1) SMALL SELLER EXCEPTION.—An exception for remote sellers with gross annual receipts in the preceding calendar year from remote sales of items, services, and other products in the United States not exceeding $1,000,000 (or such greater amount as determined by the State involved) or in the State not exceeding $100,000 (or such greater amount as determined by the State).

(2) FORM AND FILING.—A sales and use tax return for use by remote sellers and a single revenue authority within the State with which remote sellers are required to file the return. A State may not require that remote sellers submit any other sales and

use tax return other than the sales and use tax return applicable to remote sellers. A remote seller may not be required to file sales and use tax returns any more frequently than returns are required for other sellers. No local jurisdiction may require a remote seller to submit a sales and use tax return or to collect sales and use tax other than as provided by this paragraph.

(3) DEFINITION OF TAX BASE.—With respect to remote sellers—

(A) products and services subject to tax must be identical throughout the State, and

(B) any exemptions must be identical throughout the State and may not include exemptions for products and services that are not exempt when sold by other than remote sellers.

(4) SALES AND USE TAX RATE STRUCTURE.—

(A) Except as provided in subparagraph (B) of this paragraph, remote sellers must collect sales and use tax under one of three rate structures—

(i) a single State-wide blended rate that includes both the State rate and applicable rates of local jurisdictions, as determined by the State;

(ii) the maximum State rate, which is the highest rate at which sellers are required by the State to collect tax, exclusive of tax imposed by or for the specific benefit of local jurisdictions; or

(iii) the applicable destination rate, which is the sum of the State rate and any applicable rate for the local jurisdiction into which the sale was made. If a State requires that remote sellers collect at the applicable destination rate, the State must make available adequate software to remote sellers that substantially eases the burden of collecting at multiple rates within the State, and any State providing such software must relieve remote sellers from liability to that State for collection of the incorrect amount of sales or use tax, including any penalties or interest, provided that collection of the improper amount is the result of relying on information provided by that State.

(B) A State that generally imposes a lower sales and use tax rate for sales of food or drugs

and medicine, or both, may require remote sellers to collect sales and use tax at such rates.

(C) The rates described in clause (i) and (ii) must not exceed the respective average State and locality rates applicable to sellers other than remote sellers.

(c) COMMENCEMENT OF AUTHORITY.—

(1) IN GENERAL.—A State satisfying the requirements of subsection (b) may exercise the authority granted in subsection (a) beginning on the first day of the calendar quarter at least six months after the date that the State publishes the public notice described in paragraph (2).

(2) NOTICE REQUIREMENTS.—The public notice required in paragraph (1) must include the following information for remote sellers:

(A) The title and reference to the legislation that the State has enacted requiring remote sellers to collect sales and use tax.

(B) The criteria under which remote sellers are required to collect sales and use tax under the State legislation.

(C) The rate or rates at which affected remote sellers will be required to collect sales and use tax.

(D) The date upon which affected remote sellers will be required to begin collecting sales and use tax.

(E) References to compliance information and the form to be filed by remote sellers.

(d) TERMINATION OF AUTHORITY.—The authorization provided under subsection (a) shall terminate for a State that no longer satisfies the requirements of subsection (b) on the date that—

(1) a court of competent jurisdiction determines that the State's simplified system of administration no longer meets the minimum requirements set forth in subsection (b); and

(2) the determination of such court is no longer subject to appeal.

SEC. 3. PREEMPTION.

Except as otherwise provided in this Act, this Act shall not be construed to preempt or limit any power exercised or to be exercised by a State or local jurisdiction under the law of such State or local jurisdiction or under any other Federal law.

SEC. 4. LIMITATIONS.

(a) IN GENERAL.—Nothing in this Act shall be construed as—

(1) subjecting a seller to franchise taxes, income taxes, or licensing requirements of a State or political subdivision thereof;

(2) affecting the application of such taxes or requirements or enlarging or reducing the authority of any State to impose such taxes or requirements;

(3) requiring any State or any local taxing jurisdiction to exempt, or to impose a tax on any product, or to adopt any particular type of tax, or to impose the same rate of tax as any other taxing jurisdiction; or

(4) permitting or prohibiting a State from—

(A) licensing or regulating any person;

(B) requiring any person to qualify to transact intrastate business;

(C) subjecting any person to State taxes not related to the sale of goods or services; or

(D) exercising authority over matters of interstate commerce.

(b) NO EFFECT ON NEXUS.—No obligation imposed by virtue of the authority granted by section 2 shall be considered in determining whether a seller has a nexus with any State for any other tax purpose.

SEC. 5. DEFINITIONS.

For purposes of this Act, the following definitions shall apply:

(1) STATE.—The term ''State'' means each of the several States, the District of Columbia, the Commonwealth of Puerto Rico, Guam, American Samoa, the United States Virgin Islands, the Commonwealth of the Northern Mariana Islands, any other territory or possession of the United States, and any Indian country as defined in section 1151 of title 18 of the United States Code.

(2) LOCAL JURISDICTION.—The term ''local jurisdiction'' means any political subdivision of a State.

(3) PERSON.—The term ''person'' means an individual, trust, estate, fiduciary, partnership, corporation, limited liability company, or any other legal entity, and includes a State or local government.

(4) SALE INTO THE STATE.—The term ''sale into the State'' means a sale where the item sold is received by the purchaser in the State, based on the location indicated by instructions for delivery that the purchaser furnishes to the seller. When no delivery location is specified, the sale occurs in the State if the customer's billing address is in the State.

(5) REMOTE SALE.—The term ''remote sale'' means a sale of goods or services attributed to a State with respect to which a seller does not have adequate physical presence to establish nexus under the law existing on the day before the date of the enactment of this Act so as to allow such State to require, without regard to the authority granted by this Act, the seller to collect and remit taxes covered by this Act with respect to such sale.

(6) REMOTE SELLER.—The term ''remote seller'' means a person that makes remote sales.

(7) SALES TAX.—The term ''sales tax'' means a tax that is—

(A) imposed on or incident to the sale of tangible or intangible personal property or services as may be defined or specified under the laws imposing such tax; and

(B) measured by the amount of the sales price, cost, charge, or other value of or for such property or services.

(8) USE TAX.—The term ''use tax'' means a tax that is—

(A) imposed on the purchase, storage, consumption, distribution, or other use of tangible or intangible personal property or services as

may be defined or specified under the laws imposing such tax; and

(B) measured by the purchase price of such property or services.

SEC. 6. SEVERABILITY.

If any provision of this Act or the application of such provision to any person or circumstance is held to be unconstitutional, the remainder of this Act and the application of the provisions of such to any person or circumstance shall not be affected thereby.

○

Mr. CONYERS. Thank you, Chairman Smith, for a very excellent description of the issue that brings us here today. I have been working on this since 1998 with Spencer Bachus and then with Bill Delahunt of Massachusetts, and I have a bill of my own, H.R. 2701, but I want to announce today that I am going to ask all of my cosponsors to join me with the measure that is before the House today. I think this is an excellent resolution of what you have been—we have all been working on for a number of years.

This matter comes to the House Judiciary Committee because of the Commerce Clause, Article I—the commerce section, Article I, clause 3, and what we try to do is follow the advice of the *Quill* decision, and I think by addressing it we will bring about a more competitive equity among retailers. Now, I think the bottom line is simply this: Tax-free sales on the Internet may be coming to an end, and this could mean a very large boost in revenue. I think it would help the economy, and I suggest it would probably also help create more jobs.

Now, the competitors should compete on things other than sales tax policy, and so for those arguing for more of a free market, they should support eliminating any competitive advantage based on sales tax policy. In addition, uncollected sales taxes have a negative impact on local communities, including retailers and local and State governments. Now that our technology has eliminated much of the difficulty that we had experienced before with ever-increasing online sales, we can anticipate significant losses as a result of uncollected sales and use taxes. In my State I have an example that we could lose as much as $872 million during the fiscal years 2012 and 2013. Fortunately, the Federal legislature can assure a level playing field and address State revenue issues by passing this bipartisan-supported legislation that allows States to require remote sellers to collect and remit sales tax.

So with that, I join the Chairman in welcoming our two colleagues to describe their bill, and I would ask unanimous consent to put the remainder of my statement in the record.

[The prepared statement of Mr. Conyers follows:]

Prepared Statement of the Honorable John Conyers, Jr., a Representative in Congress from the State of Michigan, and Ranking Member, Committee on the Judiciary

Twenty years ago, the Supreme Court decided in *Quill Corp. v. North Dakota* that it was too difficult for a remote seller to comprehend every tax law in every state and locality in which it may sell something. In its view, states needed to simplify their sales tax laws so remote sellers could understand them easily. Otherwise, these complicated sales tax laws burdened interstate commerce.

The Supreme Court decided that without simplification, a remote seller would not have to collect sales taxes in a state in which it does not have a substantial presence, or in its view, a physical presence.

But the court did clearly state that Congress is better suited to determine whether a remote seller must collect and remit sales taxes.

It is past time for Congress to make that determination and we should do so now particularly in light of the many technological advances that have occurred since the Court rendered its decision 20 years ago.

For example, because of these technological advances, smartphones can tag a photo with the date, time, and most relevant, the *precise* location through GPS, where the photo was taken, no matter where it was taken.

Clearly, technology has eliminated the burdens a remote seller would have had in 1992. And technology has made it easier for Congress to act now. Doing so will accomplish several important goals.

By addressing the *Quill* decision, Congress will ensure competitive equity among retailers.

The Internet allows consumers to comparison shop quickly before making a final purchase. Oftentimes, a consumer can walk into a brick and mortar store, check the price of the item, ask the salesperson a few questions, and then take out a smartphone to find a cheaper price online.

The online retail price is generally lower because many Americans do not have to pay any sales tax, which can make a significant difference in the final purchase price, ranging anywhere from 3 to 12% of the price of the item.

This gives out-of-state retailers who operate online a clear advantage. They can charge the same basic pre-tax price as a local retailer for a pair of designer jeans or a video game console, but the price the consumer actually pays is lower because they do not collect a sales tax.

It is obvious why savvy consumers, especially in this cost-conscience environment, would take advantage of such considerable savings.

This also explains why the percentage of online sales and the total amount of online sales continue to increase.

Competitors should compete on things other than sales tax policy. For those arguing for more of a free market, they should support eliminating any competitive advantage based on sales tax policy.

Uncollected sales taxes also have a negative impact on local communities, including retailers, and local and state governments.

Fewer purchases at local retailers translate to fewer local jobs. Main Street retailers, local mom-and-pop stores, and even big-box retailers suffer when they lose customers because they have to collect a sales tax while online retailers do not.

Lower sales at local retailers also translate to lower revenue for local and state governments. Sales taxes constitute a significant state and local revenue source.

For example, the Census Bureau estimates that nearly *one third* of state and local revenues are derived from general sales and use taxes.

With ever increasing online sales, states and local governments anticipate huge revenue losses as a result of uncollected sales and use taxes.

For example, the Michigan Department of Treasury estimates that total revenue lost to e-commerce and mail order purchases will total $872 million during fiscal years 2012 and 2013.

The impact of such lost revenue is reflected in

- forced cutbacks to public education programs, such as sports, after-school enrichment programs, and extracurricular activities,
- delapidated roads and bridges not being repaired, and
- reductions in critical services, such as police and firefighter protection.

Just last week, the State Budget Crisis Task Force, which is led by Paul Volcker and Richard Ravitch, released a report on the plight of states.

In its report, the task force recommended that Congress should grant states the authority to collect sales taxes on online sales. Doing so would help states address their budgetary problems.

Otherwise, states will have to cut services further. Or, replace the erosion of sales taxes by increasing taxes in other areas, something anti-tax advocates would surely oppose.

Fortunately, Congress can ensure a level playing field and address state revenue issues by passing bipartisan supported legislation that would allow states to require remote sellers to collect and remit sales taxes.

H.R. 3179, the "Marketplace Equity Act of 2011," introduced by my colleagues, Representatives Steve Womack and Jackie Speier would grant that much-needed authority.

I introduced similar legislation, H.R. 2701, the "Main Street Fairness Act."

Our colleagues on the other side of the Capitol, Senators Mike Enzi, Dick Durbin, and Lamar Alexander, introduced S. 1832, the "Marketplace Fairness Act."

Although each of the three bills take different approaches, they each would accomplish the same goal: leveling the playing field between retailers and online sellers by granting that essential authority.

Today's hearing focuses on H.R. 3179, a bipartisan bill that would simplify collection rules and increase compliance. As a result, it would ensure fairness and provide a national solution.

This bill would neither impose a national sales tax nor lead to any new taxes. Consumers already owe sales and use taxes on the goods and services they purchase; however, many do not pay it voluntarily.

The business community has worked tirelessly on this issue and supports this bill. Big-box retailers, such as Walmart, Best Buy, and JC Penney, and small businesses, such as Michigan-based Marshall Music and the National Association of College Stores, are urging Congress to act and pass much-needed legislation.

Even giant online retailer Amazon.com, which has benefitted from not having to collect sales taxes in many states, supports Congress acting.

Other supporters of this legislation include at least a dozen governors—both Democratic and Republican—as well as the National Governors Association. In addition, the National Conference of State Legislatures, and the National League of Cities, along with many organizations also urge Congress to pass legislation addressing this issue.

I believe that Congress should pass legislation that promotes economic efficiency and helps our states and local governments maintain financial support for public education, health, and safety.

The Marketplace Equity Act and the other legislative proposals that I mentioned accomplish these goals.

I thank Chairman Smith for holding this very important hearing and I urge the Chairman to markup this bill at the next scheduled markup.

Mr. SMITH. Without objection, thank you for your comments, Mr. Conyers.

Our first panel consists of two of our colleagues, and they happen to be the authors of the piece of legislation that this hearing is about.

Our first witness is Congressman Steve Womack, who represents the 3rd District of Arkansas. Prior to his election to the House this Congress, he served as the mayor of Rogers, Arkansas. Congressman Womack is the sponsor of H.R. 3179, the "Marketplace Equity Act of 2011," and he is a Member of the Appropriations Committee. We welcome you here today, Steve.

Our next witness is Congresswoman Jackie Speier, who has represented the 12th District of California since 2008. She previously served on the San Mateo County Board of Supervisors and in the California State Assembly and State Senate. In the House, Congresswoman Speier serves on the Oversight and Government Reform Committee and the Armed Services Committee. She is the lead Democratic cosponsor of H.R. 3179. We welcome her today as well.

And, Mr. Womack, we will begin with you.

TESTIMONY OF THE HONORABLE STEVE WOMACK, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ARKANSAS

Mr. WOMACK. Thank you, Mr. Chairman, Ranking Member Conyers, and Members of the Judiciary Committee. Let me take this opportunity to thank you for allowing us to have this discussion today regarding an issue that Congress and only Congress can resolve. I would also like to thank my colleague and cosponsor, Jackie Speier, for her hard work and dedication to the bill before you.

In short, this bill levels the playing field in the world of retail sales. Currently, as I trust most of you now understand, traditional retailers—I will refer to them as brick and mortar retailers—collect sales taxes on purchases made in their respective stores. These taxes are remitted to the political subdivisions who levy them, typically by the State Department of Finance and Administration. This is not an option for the retailer; it is a requirement.

There is no requirement, however, for online remote retailers with no presence in a given State to collect such a tax. The United States Supreme Court in a 1992 decision, *Quill v. North Dakota*, ruled that pursuant to the Commerce Clause, States cannot make such a requirement on businesses that do not have a nexus or a presence in the State. The burden of remitting these use taxes falls on the consumer, not the retailer, and the realistic effect of this situation is bad for our traditional retailers, bad for cities, counties, and States who levy sales taxes, and bad for consumers who are unwittingly exposed to potentially incriminating audit issues.

Mr. Chairman, in short, the *Quill* decision explicitly says that only Congress can remedy this terrible disparity, and it is my strong belief that Congress should intercede.

Prior to serving in Congress I had the honor of serving as mayor of a city in northwest Arkansas that has become a premier destination for retail shopping. A revitalized Main Street and new outdoor lifestyle center in Rogers, Arkansas, were the basis for more than a billion dollars in local development during my tenure. We created thousands of jobs; revenue generated through retail sales growth lifted our city, our county, and our State. These retailers in my district and retailers across America are crying out for help to eliminate the loophole that chases more and more discriminate shoppers away from Main Street and to the Internet, where the feeling of buying something tax free is all too often a major factor for shopping online.

Small retail stores have become showrooms for their online counterparts. Merchants have intimated to me the stories of would-be consumers in growing numbers visiting their stores to get a first-hand look at the merchandise under consideration for purchase, and once committed to purchasing simply use their smartphone to purchase it online—there is an app for that—having it delivered to their home, and motivated by the opportunity to save the tax.

I do very little online shopping, but recently having made a purchase from a well known online retailer without a presence in Arkansas, I realized the burden of remitting the tax was on me. So I downloaded the proper form, filled it out, and enclosed a check to my State's Department of Finance. This is the form I used for the State of Arkansas. And there are other forms I have with me, just a sample. Three-page form from the State of Florida. Here is a form from Indiana, Virginia, Ohio, and still another from Tennessee. It occurred to me, Mr. Chairman, that a lot of my constituents don't know this is a requirement, and when told of the requirement would not know how to process that payment. These transactions, millions of them every day, are simply going without proper tax treatment, and with the exponential growth of Internet retailing, the result to traditional retailers, not to mention critical local services, is devastating.

It is time this loophole was closed. Our bill, H.R. 3179, is purposed in doing just that. It is simple and straightforward. It is not instructive, it is permissive legislation, just like the *Quill* decision invited us to do, and our bill is based on three conservative values: States' rights, allowing States to decide whether or not to compel remote sellers to collect and remit, to determine the rate and the method of remittance; promoting free market competition,

allowing the discerning shopper to make decisions on price, convenience, service, not on an outdated tax policy weighted to one business model; and keeping taxes low, helping our cities, counties, and States meet their growing demands by avoiding the certain reality of raising other taxes to offset the exponential loss of sales tax revenue.

I have heard the arguments against the legislation: It is too complicated, too many rates, punitive to small online retailers, the notion of this involving a new tax. It is not complicated. There is existing off-the-shelf software to make the necessary reports, and our bill requires the States to provide that software, and just as it is easy to track in real time approaching storms or traffic congestion, even the activities of this institution, it is also very easy for online merchants to provide the necessary documentation and payment of taxes just as their Main Street counterparts do. Plus our bill has a small business exemption to lessen the burden on the small operators and the newly formed e-retailers. And, Mr. Chairman, this is not a new tax. This is an existing lawfully due tax imposed on consumers. The difference is that it is paid to the traditional retailer at the time of purchase and the remittance is handled by the retailer, but for the online shopper, the obligation is on them.

The traditional brick and mortar retailer is not asking for special treatment. They know they have to compete against a number of consumer criterion. What they don't want and should not compete against is a disadvantage based on a tax loophole. With simple legislation, we can finally address an issue that has been 20-plus years in the making. I plead with this Committee to give favorable support to bringing this bill to the floor, and I thank you for your time.

[The prepared statement of Mr. Womack follows:]

Prepared Statement of the Honorable Steve Womack,
a Representative in Congress from the State of Arkansas

Testimony on H.R. 3179, the "Marketplace Equity Act"

24 July 2012
Steve Womack, MC, AR03

Mr. Chairman and Members of the Judiciary Committee, let me take this opportunity to thank you for allowing us to have this discussion today regarding an issue that Congress—and only Congress—can resolve. I'd also like to thank my colleague and co-sponsor, Jackie Speier, for her hard work and dedication to the bill before you.

In short, this bill levels the "playing field" in the world of retail sales.

Currently, as I trust most of you now understand, traditional retailers—I'll refer to them as "brick and mortar" retailers—collect sales taxes on purchases made in their respective stores. These taxes are remitted to the political subdivisions who levy them—typically by the state department of finance and administration. This is not an option for the retailer. It is a requirement.

There is no requirement, however, for online, remote retailers—with no presence in a given state—to collect such a tax. The United States Supreme Court, in a 1992 decision (Quill v. North Dakota), ruled that pursuant to the Commerce Clause, states cannot make such a requirement on businesses that do not have a "nexus" or presence in the state. The burden of remitting these "use" taxes falls on the consumer—not the retailer—and the realistic effect of this situation is bad for our traditional retailers, bad for cities, counties and states who levy sales taxes, and bad for consumers who are unwittingly exposed to potential tax evasion issues.

Mr. Chairman, in short, the Quill Decision explicitly says that only Congress can remedy this terrible disparity—and it is my strong belief that Congress should intercede.

Prior to serving in Congress, I had the honor of serving as Mayor of a city in northwest Arkansas that has become a premier destination for retail shopping. A revitalized Main Street and new outdoor lifestyle center in Rogers, Arkansas was the basis for more than $1 billion in local development during my tenure. We created thousands of jobs. Revenue generated through retail sales growth lifted our city, county, and state. These retailers in my district—and retailers across America—are crying out for help to eliminate the loophole that chases more and more discriminate shoppers away from Main Street and to the internet, where the feeling of buying something "tax free" is all-too-often a major factor for shopping online.

Small retail stores have become "show rooms" for their online counterparts. Merchants have intimated to me the stories of would-be consumers, in growing numbers, visiting their stores to get a first-hand look at the merchandise under consideration for purchase. And once committed to purchasing, simply use their smart phone to purchase it online—there's an APP for that—having it delivered to their home, and motivated by the opportunity to "save the tax."

I do very little online shopping. But recently, having made a purchase from a well-known online retailer without a presence in Arkansas, I realized the burden of remitting the use tax was on me—so I downloaded the proper form, filled it out, and enclosed a check to my state's Department of Finance. It occurred to me, Mr. Chairman, that a lot of my constituents don't know this is a requirement. And when told of the requirement, would not know how to process the payment. These transactions—millions of them everyday—are simply going without proper tax treatment. And with the exponential growth of internet retailing, the result to traditional retailers—not to mention critical local services—is devastating.

It is time this loophole is closed. Our bill, HR 3179, is purposed in doing just that. It is simple and straight-forward. It is not instructive—it is permissive legislation, just like the Quill Decision invited us to do. And our bill is based on three conservative values:

- States Rights—allowing states to decide whether or not to compel remote sellers to collect/remit; the rate; and the method of remittance
- Promoting free-market competition—allowing the discerning shopper to make decisions on price, convenience, service, etc—NOT on an outdated tax policy weighted to one business model!
- Keeping taxes low—helping our cities, counties, and states meet their demands by avoiding the certain reality of raising other taxes to offset the exponential loss of sales tax revenue.

I've heard the arguments against this legislation. It's too complicated. Too many rates. Punitive to small, online retailers. The notion of this involving a "new" tax.

It's not complicated. There is existing off-the-shelf software to make the necessary reports and our bill requires the states to provide that software. And just as it is easy to track, in real time, approaching storms, traffic congestion, and the activities of this institution, it is also very easy for online merchants to provide the necessary documentation and payment of taxes—just as their Main Street counterparts do.

Plus, our bill has a small-business exemption to lessen the burden on the small operators and newly formed E-retailers.

And Mr. Chairman, this is NOT a new tax. This is an existing, lawfully due tax imposed on consumers. The difference is that it is paid to the traditional retailer at the time of purchase and the remittance is handled by the retailer. But for the online shopper, the obligation falls on him/her.

The traditional, brick and mortar retailer is not asking for special treatment. They know they have to compete against a number of consumer criterion. What they don't want—and should not compete against—is a disadvantage based on a tax loophole.

With simple legislation, we can finally address an issue that has been 20-plus years in the making. I plead with this committee to give favorable support to bringing this bill to the floor.

Thank you for your time.

Mr. SMITH. Thank you, Mr. Womack.

Congresswoman Speier.

TESTIMONY OF THE HONORABLE JACKIE SPEIER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Ms. SPEIER. Mr. Chairman and Ranking Member Conyers and Members, thank you for giving us the opportunity to discuss this important issue in H.R. 3179, the "Marketplace Equity Act of 2011." Now, I am very proud to have partnered with Congressman Womack on this truly bipartisan effort. If a Republican from Arkansas and a Democrat from California can come together on a bill that deals with tax issues, then the time has really come to finally resolve this issue. And this is an issue that only Congress can resolve.

The fundamental unfairness in the marketplace and in our communities that this bill addresses has grown dramatically over the past few years. When *Quill* was decided by the Supreme Court in 1992, the Internet and the World Wide Web did not even exist. Sales taxes were collected on almost all retail sales. But according to the Commerce Department, online retail sales have increased 300 percent to $224 billion over the past 8 years, and they are expected to almost triple again over the next 8 to more than $600 billion. And this chart over here makes the case. And this is the key. It will overtake, overtake the sales at brick and mortar stores by the year 2020. This is clearly not a business model in its infancy, and there should be no doubt that this is not a new tax.

Consumers owe sales and use tax for these purchases in all States with a sales tax, but only about 1 percent actually pay them. This is an issue of collection and fairness. Some retailers have to collect the tax from the consumer and some don't for the very same product. That is just not fair.

Now, a poll commissioned by Amazon that just was released makes the case that 72 percent of respondents believe it is the seller's responsibility, not the purchaser's to collect that tax.

State and local governments impose sales tax to help pay for essential public services, such as police, firefighters, and teachers. As online sales grow, the financial hit to our communities gets more severe. Each sales tax dollar not collected is a service not provided and a possible job lost. These are cuts to police, to fire, to schools. I have seen it happen in my district, and I am sure it is happening in all of your districts as well.

Compounding the problem to our communities, the brick and mortar stores that can't compete with tax-free online sales are closing. Seven dollars out of every $10 spent at a local retailer stays local. Here is a chart over here that makes that case. More than $4 out of every $10 spent at a national retailer stays local. But none, zero of the money spent at an online retailer stays in the community. That means that with a local retailer or national retailer, they are paying their employees, they are paying rent, they are paying local taxes, but the online retailer is paying none of that.

We have all seen it, large, online-only retailers have been able to use the small retailers as their virtual showrooms. In a State

like California, that hit has been huge, particularly at a time when financially strapped consumers are looking for ways to stretch their dollars as far as possible. Technology has now made it possible for consumers to shop for goods in brick and mortar stores, get advice, kick the tires on products like TVs, computers, cameras, and bicycles and then find and buy the item online, sometimes right on their mobile phone while standing in the store.

Eric McCrystal, who runs a small power tools company in my district in San Carlos, told me it happens regularly, people come in and test his power tools, and then go online to buy because they can escape the sales tax, even though it is still owed. This simply isn't fair to the merchants like Eric who have invested in a storefront and hired employees to provide a service, and ultimately it isn't fair to the taxpayer who has the legal obligation to pay but isn't able to easily fulfill it or doesn't even know that they owe the tax and could be subject to audit and penalties for failure to pay.

As Ranking Member Conyers said, this is also about jobs. Brick and mortar retailers create four jobs for every one job created by an online retailer, and they participate in our communities. They sponsor the little league teams, they join the local Chamber of Commerce, they join the Rotary Clubs and the Lion Clubs, they are engaged in our communities. So why should we be creating an environment that places them at such a disadvantage? Why are we picking winners and losers in this particular setting?

The same way technology has made it easy for online shopping, technology has made it much simpler for online retailers to collect sales tax, and since Congress must grant this authority to the State, our bills provide a simple framework for States to opt in. It also requires States to provide cost-free the software and services to figure out the sales tax required to comply to online retailers. This is certainly more than brick and mortar retailers get.

Once upon a time there was a valid argument that the Internet marketplace was in its infancy and we didn't want to stifle its development. Those days are gone. Companies like Amazon and Overstock.com are proof of it. California is expected to lose more than $1.8 billion in uncollected tax revenues this year alone.

Now, this chart up here has every State represented by you as Members of this Committee, and you have a handout that will provide you with this data that shows an incredible loss of State revenue, State taxes, sales tax that should have been paid that was not paid, and the number is growing exponentially.

The failure of Congress to address this issue has led to more, not less, confusion in the marketplace. Instead of a national approach, desperate States are taking their own actions in response to this problem. There are the streamlining States, the Amazon deals, and the States that have expanded the reach of nexus. At least 30 States have taken some action to try and collect the sales tax owed from online sales.

Rather than hide its head in the sand, Congress could solve this issue for all States by allowing States to require online sellers to collect tax even if they do not meet a physical presence test. It could set the conditions that States must satisfy if they wish to do so, ensuring that it is simple and not unduly burdensome while at the same time respecting States' rights. That is what the *Quill* de-

cision urged Congress to do 20 years ago. That is precisely what the Marketplace Equity Act does. It is not perfect, but it is headed in the right direction, and I urge you to recognize this opportunity as one that a bipartisan Congress can fix. Thank you for the opportunity.

[The prepared statement of Ms. Speier follows:]

Prepared Statement of the Honorable Jackie Speier, a Representative in Congress from the State of California

Statement of Congresswoman Jackie Speier (CA)

Judiciary Committee full hearing

"Taxation of Internet Sales"

Tuesday July 24, 2012 10:00, 2141 RHOB

Chairman Smith, Ranking Member Conyers and members, thank you for allowing me to be here today to discuss this important issue and HR 3179—the Marketplace Equity Act. I am very proud to have partnered with Congressman Womack on this truly bi-partisan effort. If a Republican from Arkansas and a Democrat from California can come together on a bill that deals with tax issues, then the time really has come to finally resolve this issue. And this is an issue that ONLY Congress can resolve.

The fundamental unfairness in the marketplace and in our communities that this bill addresses has grown dramatically over the past few years. When Quill was decided by the Supreme Court in 1992, the internet and the World Wide Web did not even exist as a retail marketplace. Sales taxes were collected on almost all retail sales. But according to the Commerce department, online retail sales have increased 300% to $224 Billion over the past eight years, and they are expected to almost triple again over the next eight to more than $600 billion—overtaking sales at brick and mortar stores. This is clearly not a business model in its infancy.

And there should be no doubt that this is not a new tax. Consumers owe sales and use tax for these purchases in all states with a sales tax, but only about one percent actually pays them. This is an issue of collection and fairness. Some retailers have to collect the tax from the consumer, and some don't, for the very same product.

State and local governments impose sales taxes to help pay for essential public services such as police, firefighters, and teachers. As online sales grow, the financial hit to our communities gets more severe. Each sales tax dollar not collected is a service not provided and a possible job lost—these are cuts to police,

fire departments and schools. I have seen it happen in my district, and I am sure it is happening in all of your districts. Almost $7 out of every $10 spent at a local brick and mortar retailer stays local. More than $4 out of every $10 spent at a national retailer stays local. But none of the money spent at an online-only retailer stays in the community. The only option left to state and local governments facing even greater loses as more retail shifts to the internet will be to raise taxes.

We have all seen it--large online-only retailers have been able to trample the small retailers in all of our communities through the big price advantage of not charging sales tax. Across the United States, the brick and mortar stores who can compete on price but can't compete with tax-free online sales are closing, and jobs are being lost. Brick and mortar retailers create four jobs for every one job created by an online retailer.

In a state like California, that sales tax price advantage is huge, particularly at a time when financially strapped consumers are looking for ways to stretch their dollars as far as possible. Technology has now made it possible for them to shop for goods in brick and mortar stores, get advice and kick the tires on products like TVs and computers and cameras and bicycles, and then find and buy the item online—sometimes right on their mobile phone while still standing in the store.

Eric McCrystal, who runs a small powertools company in my district in San Carlos, told me it happens regularly—people come in and test his power tools and then go online to buy because they can escape the sales tax--even though it is owed. This simply isn't fair to the merchants like Eric who have invested in a storefront and hired employees to provide a service. And ultimately it isn't fair to the taxpayer who has a legal obligation to pay but isn't able to easily fulfill it or doesn't even know they owe the tax, and could be subject to audit and penalties for failure to pay.

But there are also lots of people turning to the online marketplace to expand their small businesses or to reinvent themselves after losing their job. Those legitimately small online businesses are exempted from having to collect sales taxes under this bill —but <u>only</u> until they too become sophisticated marketplace actors.

The same way technology has made it easy for online shopping, technology has made it much simpler for online retailers to collect sales taxes. And since Congress must grant this authority to the states, our bill provides a very simple framework for states to opt in to this framework. It also requires states to provide the tools and services required to comply cost-free to online retailers. This is certainly more than brick and mortar retailers get.

Once upon a time there was a valid argument that the internet marketplace was in its infancy and we didn't want to stifle its development. Those days are gone. Companies like Amazon and Overstock.com are proof of it. California is expected to lose more than $1.8 billion in uncollected tax revenue this year alone, and the amount is going up every year as more purchases are made through online retailers that have become expert at gaming the system to avoid the obligation to collect and remit sales taxes.

The failure of Congress to address this issue has led to more, not less confusion in the marketplace. Instead of a national approach, desperate states are taking their own actions in response to this problem—there are the Streamline states, the Amazon deals, and the states that have expanded the reach of nexus through legislatiion. At least 30 states have taken some action to try and increase their sales tax collections on online sales.

Rather than hide its head in the sand, Congress could solve this issue for all states by allowing states to require online sellers to collect tax even if they do not meet a physical presence test. It could set the conditions that states must satisfy if they wish to do so, ensuring that it is simple and not unduly burdensome, while at the same time respecting states' rights. That is precisely what the Marketplace Equity Act does.

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Mr. SMITH. Thank you.

Thank you both for your testimony. Appreciate your comments. And then we will move on to the next panel.

Mr. COHEN. Mr. Chairman.

Mr. SMITH. Our first witness is the Governor of Tennessee who is on his way, and when he arrives he will be introduced by the

gentleman from Tennessee, Mr. Cohen, and I will proceed to introduce the other witnesses who are here, and we will look forward to the Governor's testimony when he arrives.

Mr. COHEN. I was just wondering, until he comes could I be Alexander Haig?

Mr. SMITH. No. After the Governor, our next witness is the Honorable Wayne Harper. Mr. Harper is a member of the House of Representatives in the State of Utah and is the incoming President of the Streamlined Sales Tax Governing Board on whose behalf he is here to testify. The SSTGB was started 12 years ago with the goal of finding solutions to the complexity in State sales tax systems that resulted in the Supreme Court's holding in *Quill v. North Dakota*. Today 24 States have subscribed to its simplification principles. Representative Harper holds both a Bachelor's and Master's Degree in history from Brigham Young University. His business background is in real estate development and consulting.

Our next witness is Hanns Kuttner. Mr. Kuttner is a Visiting Fellow at the Hudson Institute, where he contributes to the Future of Innovation Initiative. He served during the George H. W. Bush administration on the White House's domestic policy staff. More recently he was a research associate at the University of Michigan's Economic Research Initiative. He is the author of many recent articles on sales taxes, including a recent article comparing origin and destination-based tax models. Mr. Kuttner holds a Bachelor's Degree from Princeton University and a Master's Degree from the Graduate School of Public Policy Studies at the University of Chicago.

Our next witness is Joseph Henchman. Mr. Henchman is Vice President of Legal and State Projects at the Tax Foundation, a nonprofit organization dedicated to educating taxpayers about all aspects of tax policy. He joined the Tax Foundation in 2005. Mr. Henchman's analysis of fiscal trends, constitutional issues, and tax law developments has been featured in numerous print and electronic media, including the New York Times, the Wall Street Journal, CNN and Fortune magazine. Relevant to this hearing, in 2007 Mr. Henchman published an article in a popular State tax periodical entitled Why the Quill Physical Presence Standard Shouldn't Go the Way of Personal Jurisdiction. Mr. Henchman graduated from the University of California at Berkeley with a degree in political science and a law degree from George Washington University.

Our last witness is Steve DelBianco. Mr. DelBianco is the Executive Director of NetChoice, a coalition of trade associations, e-commerce businesses, and online consumers, all of whom share the goal of promoting convenience, choice, and commerce on the Internet. Mr. DelBianco is well known for his expertise on Internet taxation. We look forward to his testimony on that subject today. Mr. DelBianco holds degrees in engineering and economics from the University of Pennsylvania and a business degree from Wharton. We welcome you.

Oh, the Governor has arrived and the gentleman from Tennessee, Mr. Cohen, is recognized to introduce his Governor.

Mr. COHEN. Thank you, Mr. Chairman. It is indeed my privilege to introduce our 49th Governor of the State of Tennessee, the Hon-

orable Bill Haslam. Governor Haslam is a native Knoxvillian, and I think that may be why the orange is in his tie, and is also—but he also represents the western part of the State, marrying a young lady from Memphis, Crissy, and that is why I wore my blue tie today, so we are well represented from Memphis to Knoxville. He is a graduate of Emory University, was very successful in his family business, won the governorship with the largest plurality of any Governor in the history of the State of Tennessee and probably has the highest approval ratings of any politician in the State of Tennessee. He is part of a mainstream Republican tradition in Tennessee that goes through Howard Baker, Lamar Alexander, Bob Corker, and others that have kept Tennessee in the mainstream of America. It is my honor to work with Governor Haslam. I sponsored this bill at his request early, we have worked together on other issues. Senator Alexander and Senator Corker are also sponsors, and I reflect back on his father, who was on the board here of the Kennedy Center and is a leading business person who joined with me in helping pass one of the finest lotteries in the history of this Nation and that is continually bringing in more and more money that the Governor will, I am sure, spend in a good fashion to bring back more and better educated and college graduates in Tennessee.

With that, I am especially appreciative of the Governor being here and looking forward to his testimony. I yield back the balance of my time.

Mr. SMITH. Thank you, Mr. Cohen. Governor Haslam, if you will begin.

TESTIMONY OF THE HONORABLE BILL HASLAM, GOVERNOR OF TENNESSEE, ON BEHALF OF THE NATIONAL GOVERNORS ASSOCIATION

Governor HASLAM. I will. Thank you, Congressman Cohen, we appreciate the introduction and despite occasional political differences, we appreciate your services in the State of Tennessee. Mr. Chairman, thank you very much, Ranking Member Conyers, and I appreciate you accommodating my schedule. I apologize for being a little late.

I am here to testify on behalf of the National Governors' Association, but I also think I am maybe uniquely qualified to testify on this. My family business started out with one retail store 54 years ago, has grown to have locations, 450 locations all across the U.S. and Canada. I also served as the Chief Executive Officer of Saks Direct, that is the online arm of Saks Fifth Avenue, so I understand the Internet retail business as well. I was the mayor of Knoxville for 7 years where we rely on property tax, property taxes paid not just by residents but businesses, and the critical role that having vital, healthy real life businesses matter to a city and to all of our local governments, and finally I am the Governor of a State that relies heavily on sales tax collections.

Let me be clear, I am a Republican Governor that does not believe in increasing taxes. We are a low tax State to begin with, and we have been able to cut taxes over the last 2 years. This discussion isn't about raising taxes or adding new taxes. This discussion is about States having the flexibility and authority to collect taxes

that are already owed by in-State residents. The discussion is about leveling the playing field for local brick and mortar businesses and communities across Tennessee and across the community.

I have heard Senator Alexander, as Congressman Cohen mentioned, talk about the national boot company where owners talk about customers who come in the store, try on a pair of boots, ask the employee questions about the boots, and then go home and order them online to avoid paying sales tax. As I was coming up here, I got an email from someone who heard I was coming to testify. They are a supplier to mom and pop truck accessory companies, and they said whatever you do, please tell them our story, because those mom and pop businesses that sell truck accessories are all going out of business to folks who can compete online and not have to collect the State and local sales tax.

This is an issue of fairness, comparable businesses that sell the same things that are not being treated the same. Most people that I talk to understand and agree that isn't fair. So why is it happening? Twenty years ago the Supreme Court said that States couldn't require out-of-State catalogs for online businesses to collect sales tax; it was too complicated to calculate the sales tax in each State, much less in local communities. But in the past 2 decades, technology has advanced more than anyone could have believed. It is not only possible but it is now easy for those businesses to collect the taxes that they are owed, just like local businesses with cash registers do. Current software available today, you can go find it from eight different companies, that compete to provide software that covers over 12,000 different—12,000 State and local tax rates. But this isn't only an issue that affects businesses. As State budgets are stretched and State leaders are working to provide services to taxpayers at the lowest cost, we are talking about real dollars. The current estimate of sales tax that goes uncollected each year in the U.S. is more than $20 billion. In Tennessee we believe that number to be $400 million. Where we are from, that is still real money. That money could fund critical programs that vulnerable citizens rely on, it could cover Federal mandates that States face or it could go back to the taxpayers in the form of further tax relief. We can certainly have a healthy discussion in Tennessee about how to allocate those dollars, but that is for another time. My point today is that States should have the authority to collect that money, which is already owed, and to be able to make budgeting decisions that include those dollars.

We probably all know that intuitively Internet shopping is a trend that is on the rise. My daughter-in-law buys her dishwashing detergent online. We are no longer just talking about books and scarves and a few other items. Dishwashing detergent. According to the U.S. Census Bureau, e-commerce is now 16.6 percent of all retail sales, one out of every six retail dollars happens online. It is not a small business. Retail sales grew four times faster online than they did in brick and mortar last year. Next year 25 million more—in the next 4 years 25 million more Americans are expected to shop online. The argument that this is a small piece of the economy just doesn't hold up. This is the right time for Congress to act.

Let me make a final note. As Governors and mayors, we understand that regardless of how the budget discussions come out, there will probably be less money coming out of Washington to fund State and local governments. As a Republican, I support that, and I understand that. But if that is true, then let States have the authority to collect the State sales tax that is already owed us. This is an issue of fairness, and I urge you to take up this issue at this time. Thank you very much.

[The prepared statement of Governor Haslam follows:]

Statement of Tennessee Governor Bill Haslam

Before the

Committee on the Judiciary

U.S. House of Representatives

Hearing on H.R. 3179, the "Marketplace Equity Act of 2011"

July 24, 2012

Chairman Smith, Ranking Member Conyers and members of the committee, I am grateful to be here to testify on behalf of the National Governors Association. I believe I am uniquely positioned to be before you to talk on this issue today.

I come from a family that founded and operates a national retail business based in Tennessee. I have served as chief executive officer of Saks Direct, Saks Fifth Avenue's online and catalog retailer. I was Mayor of Knoxville, a city that's budget depends on property taxes from both businesses and residents. And now I'm governor of a state that's budget relies heavily on sales tax collections.

Let me be clear – I am a Republican governor that does not believe in increasing taxes. Tennessee is a low tax state to begin with, and we've been able to cut taxes over the past two years. This discussion isn't about raising taxes or adding new taxes. This is about states having the flexibility and authority to collect taxes that are already owed by their own in-state residents.

This discussion is also about leveling the playing field for local brick and mortar businesses in communities across Tennessee and across the country.

For example, I've heard Senator Alexander talk about the Nashville Boot Company where the owner tells about a customer who came into the store, tried on a pair of boots, asked the employees questions about the boots and then went home and ordered them online to keep from paying state sales tax, which we need to remember that state law already says the customer owes.

When you buy something at the Nashville Boot Company, or any other local store, the tax you owe is calculated with your purchase, they add it to your bill, and then send the taxes owed to the state for you.

This is an issue of fairness. Comparable businesses that sell the same things are not being treated the same. Most people I talk to understand that and agree that isn't fair.

So why is this happening today?

Because 20 years ago the Supreme Court said that states couldn't require out-of-state catalogs or online businesses to collect sales tax because it was too complicated for them to calculate the sales tax in each state, much less in local communities. But in the past two decades, technology has advanced more than almost anyone could have believed, and it is not only possible, but it is easy, for these businesses to collect the taxes owed just like local businesses with cash registers do.

Current software covers over 12,000 state and local tax rates, and there are at least eight companies already competing to provide software that is affordable to even the smallest businesses.

But this isn't only an issue that impacts business. As state budgets are stretched and state leaders are working to provide services to taxpayers at the lowest cost in the most efficient and effective way, we are talking about real dollars.

The current estimate of sales tax that goes uncollected each year in the United States is more than 20 billion dollars. In Tennessee, we believe that number to be 400 million dollars. That money could fund critical state programs that vulnerable citizens rely on; it could help cover federal mandates that states face; or it could go back to the taxpayers in the form of further tax relief.

We would certainly have healthy discussions in Tennessee about how to allocate those dollars, but that is for another time. My point today is that states should have the authority to collect that money, which is already owed, and to be able to make budgeting decisions that include those dollars.

We probably all know this intuitively - Internet shopping is a trend that is on the rise. When my daughter-in-law buys her laundry detergent online, that tells you something.

According to the U.S. Census Bureau, e-commerce represented 16.6 percent of retail sales in 2011, and online sales grew 16.1 percent compared to overall retail sales which grew 4.7 percent.

More and more people are doing their shopping online and are expected to spend more money.

According to Forrester Research, 25 million more Americans are expected to shop online in four years, and each shopper will spend an average of $530 more (up from $1,207 in 2012 to $1,738 in 2016) *[Forrester Research: U.S. Online Retail Forecast, 2011 to 2016]*.

The argument that this is a small part of the economy doesn't hold up.

This is the right time for Congress to act.

As a governor, I realize in the coming years that Washington is going to be sending states and local governments less and less money as you tackle the nation's debt. And as a Republican, I am proud of you for doing that. But if that is the case, then you should also allow each state to have the flexibility to make decisions about this issue and to collect taxes that are already owed.

This is a conversation about fairness. Fairness to states in allowing them to manage their own budgets, and fairness to local businesses that are part of the fabric of this country, are vital to our economy and our entrepreneurial identity.

Thank you.

Mr. SMITH. Thank you, Governor.

Mr. COBLE [presiding]. Thank you, Governor. Mr. Harper, you are next in line.

TESTIMONY OF THE HONORABLE WAYNE HARPER, UTAH HOUSE OF REPRESENTATIVES, ON BEHALF OF THE STREAMLINED SALES TAX GOVERNING BOARD

Mr. HARPER. Thank you. Thank you, Chairman, Ranking Member Conyers, and Members of the Judiciary Committee, for the opportunity to present today.

Today Congress is facing one of the most challenging issues regarding State authority over their taxes and also one of the most challenging issues for our retailing community. I am a Republican State representative from Utah, and I chair the House Rules Committee. I come before you today in my role as someone who is responsible for producing a balanced State budget, reducing government's burden on business, and is the incoming President of the Streamlined Sales Tax Governing Board.

I appreciate the title of today's hearing. That subject is of paramount urgency and importance. As you know, two U.S. Supreme Court decisions of the previous century are the basis of this hearing. The crux of the issue Congress is addressing, why we are here, is the competitive advantage government grants certain retailers over others. The bottom line problem that exists today is the 6 to 10 percent government-mandated price difference. Remote businesses selling the same product as a retailer in your hometown has an inherently lower end-transaction price. Government is picking winners and losers under the current court decision. I come before you today to ask you to exercise your congressional authority and end the current government sanctioned tax in business inequality.

According to the Department of Commerce, e-commerce sales in 2005 were $87 billion. This year e-sales will total more than twice that amount. The stark truth, as has been stated before, is that local retailers across the country often find themselves acting as the display case for consumers who come in and try out the product but then go home and buy it online. Why? Because there is a court and government sanctioned incentive to buy remotely as remote sellers are not required to collect sales tax, as are stores in your hometowns. Also States are not receiving the taxes they need to either provide services or cut their tax rates.

Let's investigate some of the arguments regarding tax parity and simplification. First, some argue that it is impossible or expensive to collect online or catalog sales tax. In many ways the Internet is the perfect environment in which to collect sales taxes. The consumer is already supplying to the vendor in their shopping cart all data that is needed to collect due sales tax. Existing technology available from over eight companies allow for the easy collection of the due sales tax. For example, eBay is currently doing a pilot program with two companies that, and I quote, deliver small and mid-sized businesses a fast, easy, accurate, and affordable solution for achieving sales and use tax compliance.

Second, some opponents will argue against placing another burden on business, and especially on small business. Unfortunately, today the real burden is on those retailers who are trying to com-

pete against someone who isn't collecting due sales tax. Your hometown retailers are at the mercy of a 6 to 10 percent government-mandated price disadvantage. That I submit is the real burden on small business.

Third, some groups will ask you, will tell you that these bills are a tax increase. That is not true. How, may I ask, is collecting a tax you owe but are not paying a tax increase? Asking one retailer to collect sales tax simply because they have a store in your hometown without asking the same of all retailers doesn't seem like equal protection under the law.

Four, some groups claim that States don't do a good enough job collecting the use tax. Under current court rulings there are basically only two ways to collect the use tax, have the retailer collect it or educate, then audit consumers. To those who argue that States should engage in more audits, I would ask if they really think we should have a more intrusive collection system in which the average consumer will be made to feel as if they have a resident auditor at their kitchen table. I resoundingly say no.

Fifth, some opponents will say that the States have not simplified their tax systems enough to warrant congressional authority. What the Supreme Court didn't answer in 1967 was how much simpler the State sales tax system would have to be and what technology would have to exist to rule differently. The debate since Bellas Hess decision is how much simplification must be done.

In conclusion, I would submit that technology has so radically improved that the challenge issued by the Supreme Court has been answered. Resolving a 50-year-old tax inequity will ensure fairness for all. With this bill, Congress is authorizing a collection tool, not a new tax nor is it a tax on retailers. It is time now to eliminate the government-sanctioned competitive advantage some retailers have over your hometown businesses. It is time to end government picking winners and losers in the retail community. It is time to treat all retail businesses the same. I believe Congress has the ability to balance appropriately the needs for simplification, State sovereignty in tax matters and equity. I encourage you to make that decision and to act now. Thank you.

[The prepared statement of Mr. Harper follows:]

Testimony of Utah State Representative Wayne Harper before the Judiciary Committee of the United States House of Representatives on July 24, 2012:

Thank you Chairman Smith, Ranking Member Conyers and Members of the Judiciary Committee for the invitation to talk to you today. Today, Congress is focusing on one of the most serious issues facing state authority over their taxes, and also one of the most challenging issues for our retailing community.

Introduction:
I am a Republican State Representative from Utah. I chair of the House Rules Committee. I come before you today in my role as someone responsible for producing a balanced state budget, reducing government's burden on business and as the in-coming president of the country's most successful business tax simplification initiative.

Background:
I appreciate the title of today's hearing: "H.R. 3179, the "Marketplace Equity Act of 2011." That subject is of paramount urgency and importance. As you know, two US Supreme Court decisions of the previous century are the basis of this hearing and the situation in which states and business find themselves in this century. Since Bellas Hess was decided in the 1960's, I don't believe that anyone could have imagined how that Court's interpretation of the Constitution's limitations on state taxes would produce such an ominous effect for state budgets and for retailers that exist today. When the Court decided Bellas Hess over four decades ago, this focus and issue was on catalog sales. While catalogs offered greater variety than many stores at that time, catalogs could not compete with local customer service and immediate availability. In contrast, today, one day and two day delivery of ordered goods is normal, and same day delivery is possible. Retailers are accustomed to competition and improved business and delivery models. However, the crux of the issue Congress is addressing, why we are, is the competitive advantage government grants certain retailers over others. The bottom line problem that exists today is the 6-10% government mandated price difference. Remote business selling the same product as a retailer in your home town has an inherently lower end transaction price. Government is picking retail winners and losers under the current Court decision.

The second case, Quill, circumscribed the state's authority over its own tax codes. In Quill, the US Supreme Court made it clear that a state's ability to employ an effective sales tax was going to depend on the authority granted by Congress under the Commerce Clause. I come before you today to ask you to exercise that authority and end the current government sanctioned business inequality.

E-commerce Sales:
According to the Department of Commerce e-commerce sales in 2005 were $87 billion. This year e-sales will total more than twice that amount. The quarterly e-commerce sales in 2011 increased on average 17% more than the same quarters in 2010, while total sales increased less than 8%. While that difference may seem great, it is actually below normal for e-commerce sales. Prior to this year e-commerce sales increased at a much greater rate than did total sales. If e-commerce sales are increasing at a rate greater than total sales, the difference must be sales that would have otherwise gone to a local retailer. The stark truth is that local retailers across this

country often find themselves acting as the display case for consumers who come in and try out the product but then go home and buy it on-line. Why? Because people want to save money on purchases and because there is a Court and government sanctioned incentive to buy remotely due to the nearly 50 year old Bellas Hess decision that remote sellers are not required to collect sales tax as are stores in your home towns. Bottom line is that states fund critical governmental services with sales tax. Certain retailers are not collecting due sales and use taxes on transactions, taxpayers generally are not remitting use taxes and states are not receiving the taxes needed to either provide services or cut their tax rates.

Let's investigate some of the arguments against parity and simplification.

First, Collecting is too complex:
Some continue to argue that it is impossible or expensive to collect sales tax on-line or via a catalog. Every retailer today looks to automate everything that can be automated. Sales tax collection software exists, it works, and it is affordable. Computer technology and supply chain management have radically changed retailing. In many ways the Internet is the perfect environment in which to collect sales taxes because sales tax collection can be automated. The customer is already supplying to the vendor in their shopping cart, all data that is needed to collect due sales tax. Existing technology available from over 8 companies allow for the easy collection of due sales tax. For example, E-Bay is currently doing a pilot program with two companies that, and I quote: *"delivers small and mid-sized business a fast, easy, accurate and affordable solution for achieving sales and use tax compliance."*

Second, Impact on small business:
Some opponents will argue against placing another burden on businesses, and especially on small business. Unfortunately, today the real burden is on those retailers who are trying to compete against someone who isn't collecting due sales tax. Your home town retailers are at the mercy of a 6-10% government mandated price disadvantage. That is the real burden on most small business. The mom and pop businesses in each of your districts are fighting to survive, and are being discriminated against by last century's Court decisions and technology. For truly small businesses for which collecting sales tax truly could be a burden, Congress protects them with a small sellers exemption threshold in all of the bills introduced. That exemption is for REMOTE sales. Congress also helps businesses that exceed the threshold and would be required to collect by 1) requiring states to simplify their laws and processes, and 2) by requiring states to provide software. These and other safeguards, I support.

Third, Collecting a tax that is already due is a tax increase:
Some groups will tell you that these bills are a tax increase. That is not true. How, may I ask, is collecting a tax you owe, but are not paying, is a tax increase? Use tax is on the books of state in this country. If this theory were taken to its logical extreme, every audit assessment would be a tax increase since someone is being forced to pay a tax they hadn't paid. The obligation to pay sales tax on retail sales, regardless of transactional location, exists today. Asking one retailer to collect sales tax, simply because they have a store in your home town without asking the same of all retailers doesn't seem like equal protection under the law.

Fourth, States have not done enough to collect the tax owed today:
Some groups claim that states don't do a good enough job collecting the use tax. Under current Court rulings, there are basically only two ways to collect use tax: have the retailer collect it, or educate and then audit consumers. There is nothing more inefficient, onerous or agitating than conducting an audit on individual consumers. To those who argue that states should engage in more audits, I would ask if they really think we should have a more intrusive collection system in which the average consumer will be made to feel as if they have a resident auditor at their kitchen table? I resoundingly say no!

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

Sixth, Business has not been involved:
In the vein of business simplification and parity, states and the business community have been cooperatively working for over 10 years to simplify sales tax collection and administration. In addition to the decade long streamlined sales tax effort, states and the business community have been working on documents and Resolutions that specify principles and elements that should be in the federal legislation. For example, Utah adopted HJR 14 this year, which is a list of simplifications principles that should be included in federal legislation addressing Quill and Bellas Hess. That Resolution was a cooperative effort between the Utah's legislature, retail community and Utah based on-line retailer Overstock.com. Additionally, national organizations, on-line retailers, brick and mortar retailers and elected officials have been working on principles and areas of simplifications that should be in a federal bill. Significant progress and agreements have been made.

In conclusion, I submit that technology has so radically improved that the challenge issued by the Supreme Court has been answered and successfully resolved. It is time now to eliminate the government sanctioned competitive advantage some retailers have over our local retailers. It is time to end government picking winners and losers in the retail community. It is time to treat all retail businesses the same. I believe Congress has the ability to balance appropriately the needs for simplification, state sovereignty in tax matters, and equity. I encourage you to make that decision and act now.

Principles and Simplification Elements that should be Addressed in Federal Sales Tax Legislation

1. State certified tax collection and remittance software that is readily available and affordable.
2. Immunity for civil liability for retailers using state certified software.
3. Uniform definitions between states so that retailers have a clear understanding of terms when collecting a tax.
4. Rate simplification as an option.
5. Single state sales tax return
6. Single state tax audit
7. Jurisdictional boundary database created, updated and managed by the state and no liability to the retailer who uses the database for errors in the database.
8. Uniform sourcing rules.
9. Small business exemption.
10. Reasonable vendor compensation.

Mr. COBLE. Thank you, Mr. Harper.

Gentlemen, we try to work within the 5-minute rule if possible, so if you could, when the red light appears on your panel that says to you that the ice is getting thin upon which you are skating, but you won't be keelhauled for violating it.

Mr. Kuttner, we are glad to have you next in line.

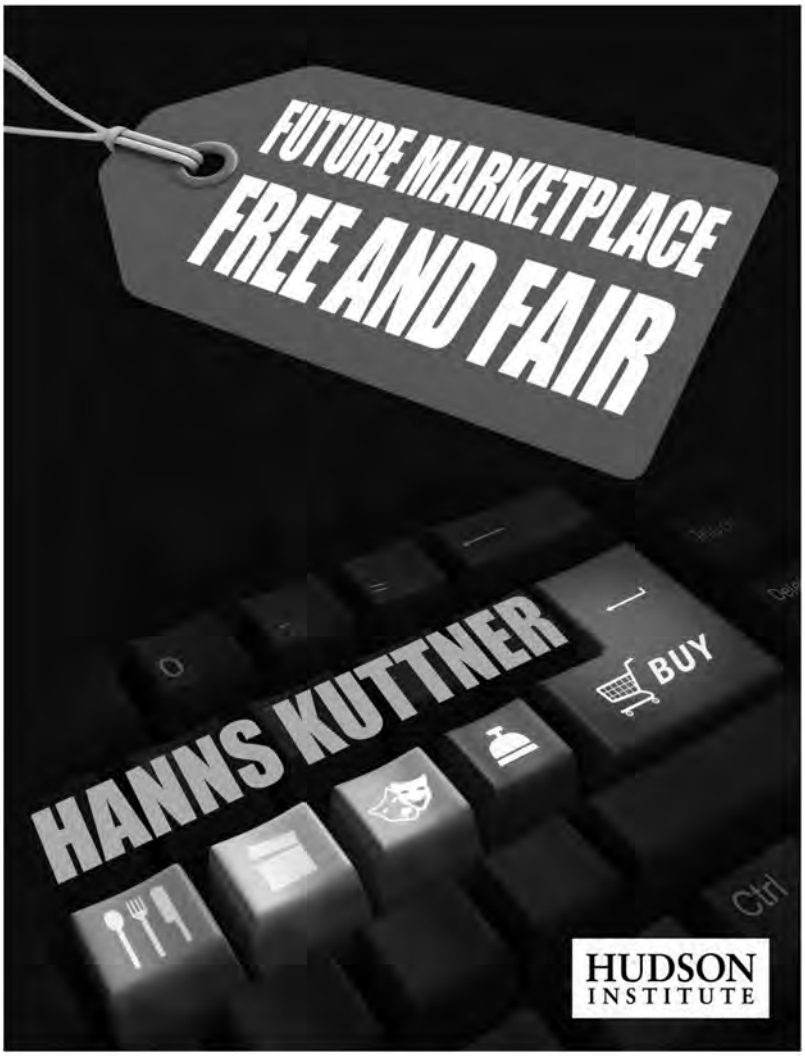
TESTIMONY OF HANNS KUTTNER, VISITING FELLOW, HUDSON INSTITUTE

Mr. KUTTNER. Thanks so much, and I have been forewarned. Well, as part of what we are doing at Hudson Institute looking at innovation, I would be very interested in innovation in buying and selling, and I have prepared two reports in this area.

Mr. WATT. Could the witness pull the mike closer to him?

Mr. KUTTNER. One entitled Future Marketplace Free and Fair, another about some of the issues that have come up in thinking about an origin-based versus destination-based sales tax, and I would be very appreciative if they could be made a part of the record of this hearing.

[The information referred to follows:]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Future Marketplace: Free and Fair

by Hanns Kuttner

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Future Marketplace: Free and Fair

> New technologies have brought broader choices and more competition. They have expanded the scope of the market. But when these technologies allow turning the sales tax difference into a price advantage that tips the scales from one seller to another, they confer special treatment.

In any market, buyers seek out the seller who offers the lowest prices and best terms. Government can distort markets by decreasing or increasing prices through subsidies, taxes or regulation. Compared to a free market, distortion means different sellers get the sale and at different prices.

Current federal policy on state sales taxes yields a distortion. The result is prices and pairing up of buyers and sellers that differ from the free market result. These distortions mean a loss of economic efficiency. Goods move more. Consumers respond to differences in price based on tax differences, not differences in how efficiently goods and services can be produced. These differences create a deadweight loss that burdens the economy. Changes in technology, many rooted in the Internet, mean this distortion will become larger in the future.

Forty-five states, home to 97 percent of the American people, have a sales tax. States may impose a sales tax but federal policy creates a loophole for out-of-state sellers. Sales tax often goes uncollected on sales across state lines. Imperfect collection results in a preference for buying from out-of-state. This distortion will effect the sale of up to $330 billion worth of goods and services in 2012.

The distortion stems from the price difference the sales tax can create when buyer and seller are in different states. States require in-state businesses to collect the sales tax owed on sales within the state. Federal policy does not allow states to make the same requirement of out-of-state sellers. The tax difference functions as a subsidy, putting a wedge between the true economic cost and the price paid by the buyer. A free market offers the highest possible level of efficiency. This wedge detracts from efficiency.

The implications of tax differences have grown as new technologies have made it easier for distant buyers and sellers to come together. The ways to reach customers across state lines have grown, as new technologies become available. Catalogs were once the state-of-the-art; today the Internet has that distinction.

New technologies have brought broader choices and more competition. They have expanded the scope of the market. But when these technologies allow turning the sales tax difference into a price advantage that tips the scales from one seller to another, they confer special treatment.

Buyers seek out the lowest price. That lowest price can be the actual lowest price or it can be the result of government distortion that favors one group of sellers. A market in which one seller collects the sales tax, and another does not, distorts the location of sales. Compared to the division that would prevail in a free market, out-of-state sellers get a larger share in a market where state governments must give a preference to out-of-state sellers.

The view that the Internet is a sales-tax-free zone is outdated. We estimate that sales tax is now collected on more than half of all Internet-facilitated sales which are subject to sales tax in the buyer's state. Two forces drive this conclusion. First, tax compliance via the use tax among businesses means high compliance for that portion of Internet sales. The use tax is the form of the sales tax paid by the purchaser when buying from out of state. Sales between businesses remain a much larger share of Internet sales than sales to consumers. Second, the growth in multi-channel sellers—those that sell through both the Internet and physical stores—has lead to more sellers collecting the sales tax for multiple states.

The subsidies and distortions that result from the loophole currently required by the federal government are longstanding. As developments in technology narrow the distance between buyers and sellers, more commerce will be "e-commerce." Thus the size of the subsidy and resulting distortion will grow, even if marketplace developments also lead to a larger share of sales occurring between parties who collect the sales and use taxes.

This report explains how this distortion and its subsidy for out-of-state sellers has come to be and how the federal government keeps the loophole from being closed. It also reviews policy options for addressing it. These range from ways to level the playing field to changing the sales tax from a tax on purchasers to a tax on sellers.

Subsidies as a Source of Distortion in a Free Market

In a free market, buyers and sellers come together and agree on a price. What it means to come together is changing. Over time, a declining share of market transactions involve face-to-face interaction, a trend that will continue, spurred by developments in communications technologies. A succession of new technologies has created alternatives to face-to-face dealings: Benjamin Franklin is credited with introducing the first mail-order catalog. Where the alternatives serve buyers better than face-to-face, buyers have embraced them. The alternatives have come to include catalogs, toll-free calls to call centers, and a variety of information technologies that can be gathered under the heading of e-commerce. Altogether these alternatives are the different forms of "remote selling."

Sales take place through either face-to-face interactions or through one of the forms of remote sales. The equilibrium between physical presence and remote sales in the market for each good or service reflects many factors. Some relate to the nature of the good or service being sold. Others relate to purchaser preferences. Together these forces determine the free market division between face-to-face and remote sales.

However, a distortion in the marketplace, whether from subsidies, taxes, or regulation, will change this division and cause a loss of efficiency relative to a free market.

Current policy makes the sales tax a distortion. Current policy has the effect of giving remote sellers a price advantage, allowing them to sell their goods and serv-

THE SALES AND USE TAX: A CONSUMPTION TAX, AMERICAN STYLE

The state and local sales tax in the United States is a type of consumption tax. Unlike taxes on income or capital, consumption taxes do not distort decisions to work, save, or invest. Taxes on sales are the most important revenue source for state governments, amounting to 48.9 percent of total state tax revenue in 2010.[1]

Each state (and in some cases, local government) decides what is subject to tax. Looking across what is and what is not subject to the sales tax, one sees that the tax base does not include many forms of consumption.

A larger share of goods than services is subject to the sales and use tax. States begin with the presumption that goods are taxed and then exempt some goods (with food for home consumption and prescription drugs the goods most frequently exempted.) With services, state law names particular services that are taxed.[2] As the American economy has grown and changed over time, services have become a larger share of the economy, and thus the share of purchases subject to the sales and use tax has fallen. Within consumption expenditures, the sales tax could be seen as an incentive to consume untaxed services rather than taxed goods.

When consumers buy things or services subject to the sales and use tax, they pay the tax. Businesses also pay the tax, a feature that makes the American sales tax different from the consumption tax in many other countries. While states typically exempt goods purchased for resale from wholesalers or inputs used by manufac-turers, businesses pay sales tax on things they use, such as office supplies. These costs carry forward into the prices businesses charge for the goods and services they produce, making this component of the sales tax one that is also ultimately paid by consumers.

The sales tax is both a transparent tax and an invisible tax. Consumers receive receipts that show just how much sales tax they paid on that purchase. The invisible portion of the sales tax is the amount that sellers pass forward to purchasers as part of the price of the good. This invisible part is much smaller than it would be if large classes of sales, such as those by wholesalers to retailers, were not exempt.

The largely-visible sales tax administered by states in the US compares to "value-added" style consumption taxes that are included in the price of the good or service in many countries.

1. (Dwyl) Lee, Robert Jean Williams and Nancy J. Higgins. "State Government Finances Summary: 2010," (The ASPFS, December 2011. Washington: Census Bureau.
2. For example, see the questionnaire prepared by the Federation of Tax Administrators listing the statutory sales tax of 164 services. http://www.taxadmin.org/fta/publ/service/taxff09.html

ices without collecting the sales tax owed by the purchaser. This price difference functions like a subsidy. It distorts the allocation between the two forms of selling. The subsidy from not collecting tax due means a larger share of sales will take place remotely than would occur in a free, undistorted market.

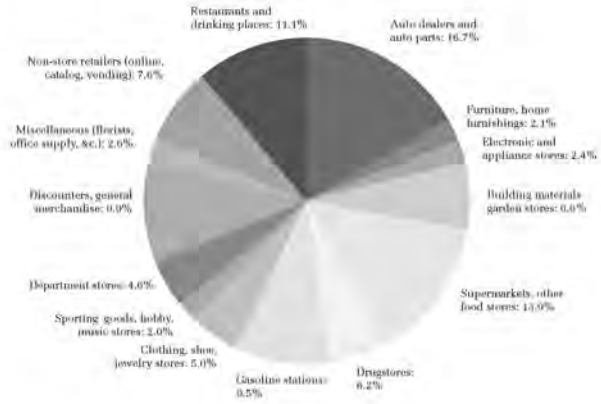
The sales at stake are largely in the retail market for goods. Some services, such as hotel and motel rooms, fall within the scope of the sales tax base in many states. Most services, including hospital and medical services, tuition, personal services such as hair treatment, and the services of lawyers and other professionals, are not subject to sales tax in most states. The Census Bureau surveys retailers about their sales; **Figure A** breaks down the retail market by type of seller. This provides a sense of the retail market, although not one that tracks perfectly to the sales tax base (for example, food for home consumption is taxed in only some states.)[1]

The difference in the face-to-face/remote split under a free market and a market with distorting subsidies varies according to the nature of the good or service. Four factors that influence the efficient allocation between face-to-face and remote sales are:

- **Standardization.** Products that have standard descriptions or characteristics make it less important for the purchaser to assess goods in person before buying. Standardization increases the potential share of purchases made without face-to-face interaction. The availability of standards for many industrial commodities (grades

FIGURE A
Total: $4.1 trillion

Retail and Food Service Sales, 2009



Source: U.S. Bureau of the Census, "Estimated Annual Sales of U.S. Retail and Food Services Firms by Kind of Business: 1992 Through 2008," March 2010 (http://www.census.gov/retail/)

of steel, standards for purity of chemicals) helps explain why "business to business" sales dominate the dollar volume of e-commerce.

Individual consumers also buy standardized products. Make and model numbers allow consumers to know the product offered online is the same as what they see in stores.

• **Product comparability.** A pad of paper is just as useful if it comes from a local vendor or a vendor several states away. With some goods, but especially with services, having to wait two days is not as valuable as having something now. Immediacy can be an important component of some purchases. Further advances in logistics would be required for remote sellers to erode the strong advantage of physical sellers. Restaurants offer an example. A remote seller offering a meal that will be delivered tomorrow and which must be warmed upon arrival is a weak competitor to a restaurant that offers a meal served within the hour.

• **Cost of transportation.** The additional cost of sending goods hundreds of miles can be a small share of the final sale price for some goods and a large share for others. This effect can undo the price advantage of a remote seller who does not collect the sales tax. Garden mulch is an example of a category where the price difference from not collecting the sales tax does little for remote sellers. Transportation costs represent a large share of the cost of mulch for landscaping. Software represents the opposite case. Software can be downloaded via the Internet. The transportation cost does not vary with the distance the product travels.

• **Consumer preference.** The conditions of a competitive market often leave little room for factors other than price and objective characteristics to influence business-to-business sales. That does not hold for sales to consumers. Each consumer has a different attitude towards the shopping experience. Some enjoy giving close personal examination before buying. Others do not enjoy shopping and would be willing to pay more for the privilege of not going to a store to buy. Even at the level of the individual consumer these attitudes can vary from product category to category.

The size of the distortion, measured as the difference between the share that occurs in a subsidized and a free market, depends on how sensitive sales are to the price difference the subsidy creates. Where price is the first, last and only criterion in the purchaser's decision making process, the gap is larger. Goods and services with a high degree of standardization, comparability between local and remote sale, and low cost of transportation are most likely to have a larger gap between the efficient and the subsidized division between face-to-face and remote sales. **TABLE 1** shows categories where there is a low, medium, and high potential for distortion because of the subsidy.

TABLE 1.

Potential for Remote Sales

Low
Convenience purchases
Gasoline
Motor vehicles
Personal services
Restaurant meals
Hotel and motel rooms

Medium
Appliances
Furniture
Insurance

High
Books
Clothing
Consumer electronics
Music recordings
Office supplies

TABLE 2
SALES VENUE IN PLAY

	Total Untaxed Out-of-State Sales ($, billions)	Average Sales Tax Rate (%)	Sales Tax Due ($, millions)
Alabama	4.21	8.25	347.7
Alaska	0.22	1.40	3.0
Arizona	8.60	8.15	700.9
Arkansas	2.86	6.25	230.3
California	50.73	8.20	4159.7
Colorado	5.51	6.40	352.6
Connecticut	2.40	6.35	152.4
District of Columbia	1.21	6.00	72.5
Florida	22.31	6.65	1483.7
Georgia	12.05	6.95	837.6
Hawaii	2.82	4.35	122.5
Idaho	1.70	6.05	103.1
Illinois	13.40	7.90	1058.6
Indiana	5.70	7.00	398.8
Iowa	2.64	6.85	181.0
Kansas	4.65	6.00	279.2
Kentucky	2.57	8.75	224.5
Louisiana	16.17	5.00	808.3
Maine	1.09	6.00	65.4
Maryland	6.02	6.25	375.9
Massachusetts	4.47	6.00	268.0
Michigan	4.01	7.20	289.0
Minnesota	6.50	7.00	455.2
Mississippi	4.18	7.25	303.3
Missouri	7.17	6.00	430.2
Nebraska	1.50	7.85	118.1
Nevada	4.96	6.95	344.9
New Jersey	6.31	6.55	413.4
New Mexico	2.91	8.45	246.0
New York	25.80	6.85	1767.0
North Carolina	7.46	5.85	436.5
North Dakota	0.46	6.80	31.3
Ohio	7.67	8.20	628.8
Oklahoma	4.63	6.40	296.3
Pennsylvania	12.84	5.50	706.2
Rhode Island	1.01	7.00	70.4
South Carolina	3.56	7.15	254.3
South Dakota	1.11	5.50	60.8
Tennessee	7.02	9.45	748.5
Texas	22.21	8.00	1777.1
Utah	2.70	6.70	180.7
Vermont	0.74	6.05	44.8
Virginia	8.45	5.00	422.
Washington	6.15	8.80	541.0
West Virginia	1.72	6.00	103.3
Wisconsin	5.30	5.45	289.0
Wyoming	1.14	5.40	61.7
Total	329.04		23260.0

Sources: Sales tax due: National Conference of State Legislatures
Sales tax rates: The Sales Tax Clearinghouse (rate is sum of state and average local (city and county) rates).

“

Electronic interchange has made tremendous inroads in how businesses come together to buy and sell. The purchasing agent working with a stack of product catalogs on his or her desk has given way to a purchasing agent going to a web site, perusing the electronic version of the paper catalog, and placing an order.

The four factors that influence the share of sales that are face-to-face versus remote make it not surprising that "business to business" ("B2B") sales dominate e-commerce. At this point in the evolution of the marketplace, remote selling has obtained a far greater share of the B2B market than sales by businesses to consumers ("B2C"). The Census Bureau estimated that in the third quarter of 2011, retail e-commerce sales were 4.6 percent of all retail sales.[3] While about triple the level of about a decade ago, it is still far below the level that it could reach as both the technologies that allow access to e-commerce and those that define the Internet buying experience increase their capabilities.

How Much Subsidy is There?

The subsidy is the sum of the price advantage that out-of-state sellers get from being able to offer prices that do not include the sales tax in the customer's state. Using the most recent estimates from the National Council of State Legislatures (NCSL), the total amount of sales with sales tax not collected will be $330 billion in 2012. The average state and local sales tax rate in the sales tax states is 7.05 percent under tax rates that applied late in 2011. Applying the sales tax rates to these sales produces a sales tax amount of $23.3 billion. **TABLE 2** on the opposite page shows the amount of sales and sales tax

involved in each of the states which imposes a sales tax.

The $330 billion in sales is a measure of the distortion from the current loophole that keeps states from collecting tax on sales to their residents. It shows the maximum amount of sales that could change sales mode if the loophole closed. The extent to which sales would change from remote to local if states collected tax on the remote sale depends on how much sales respond to changes in price. Some sellers who have used the tax differential as a way to charge higher prices may lower their prices to keep the sale.

Changing Technology and Efficient Division between in Person and Remote Sales

The level of sales that benefits from the favorable treatment enjoyed by out-of-state sellers reflects both long-standing technology and more recent innovations.

Remote selling is not new. Montgomery Ward and Sears, Roebuck and Co. pioneered mass catalog selling in the 19th century, long before any state imposed a general sales tax.

Each successive innovation in technology has brought new opportunities for remote selling. Toll-free numbers advertised on radio and television created new opportunities for sellers to find customers across state lines. A steady decline in the real price of computing power has enabled catalog sellers to buy and exchange lists, mining data to target their mailing to customers who are most likely to buy.

Electronic interchange has made tremendous inroads in how businesses come together to buy and sell. The purchasing agent working with a stack of product catalogs on his or her desk has given way to a purchasing agent going to a web site, perusing the electronic version of the paper catalog and placing an order. In other cases, where volumes are larger and processes more integrated, the purchasing agent has been replaced by software. One company's production planning system electronically interacts with the supplier's software to place an order. In the case of multiple vendors, the production planning system may electronically request bids, receive those bids, and apply algorithms the purchaser has developed to decide which bid to accept. Efficiency explains much of why electronic interchange has made inroads in how businesses interact with one another.

The movement to e-commerce has been uneven across markets. While the average consumer is more familiar with remote selling and e-commerce in the form of catalogs and merchant web sites, the dollar amounts are much greater in proprietary electronic data exchange relationships between businesses. For example, among manufacturers, 42 percent of the dollar value of shipments in 2009 involved a sale that took place via e-commerce. Among wholesalers, beverage and tobacco products had 59 percent of the dollar value of shipments take place as a result of an e-commerce sale. The retail sector lags far behind: only 4 percent of retail sales involved e-commerce; the overwhelming majority still take place in face-to-face sales.[3]

The consumer market (referred to as "business to consumer" or "B2C") lags the "business to business" (or "B2B") market. While it has lagged, the B2C side also has many more possibilities for future growth.

Even as growth proceeds more rapidly on the B2C side, some possibilities appear unlikely. Standardization, comparability and transportation costs mean many products have intrinsic limitations that make e-commerce unlikely. Many services, whether restaurant meals or a massage, are in this category. The small quantities in which consumers buy many products give an advantage to physical sellers who realize scale economies by taking shipments in a case. Buying a pack of gum will remain a transaction that only takes place through physical sellers.

However, advances in technology are rapidly changing the efficient allocation between physical and remote sales. Changes in telecommunications technology are rapidly shifting the equilibrium point between physical and remote sales. The speed at which consumers are able to access the Internet has gone up. The term "Cyber Monday," referring to a rush of Internet sales when consumers returned to work on Monday after Thanksgiving, had its origins in a time when workplaces typically had much faster Internet connections than homes. Broadband's growing availability has made the average at-home Internet upload and download speed much higher.

Other changes in telecommunications technologies are increasing the opportunities for consumers to buy remotely. The omnipresence of access to the Internet is giv-

ing a new meaning to "24/7." At the time of the Internet boom in the late 1990s, buying something over the Internet meant sitting down at a desktop computer with an Internet connection. The emergence of smartphones and tablet computing has put individuals within reach of the Internet for more of their waking hours. The thought of buying something over the Internet need not be deferred until arriving at home or the office to sit down in front of a computer and place an order.

Other changes are blurring the line between physical presence and e-commerce. Sellers that have both web sites and physical stores already offer the opportunity to order products on the web site and pick them up in a physical store. Cell phone apps offer the potential for a consumer to visit a store, identify the product he or she wants to buy, but decide he or she wants to have a different color. The in-store merchandising could show the range of colors available. The consumer could decide to buy a color not on display and use a cell phone app to order the preferred color to be shipped to his or her house.

With the retail sector so far behind other sectors of the economy in the share that is e-commerce, the balance between physical presence and e-commerce seems almost certain to shift further towards e-commerce. Sales from manufacturers to wholesalers and wholesalers to retailers are largely exempt from the sales tax, which falls mostly on sales made by retailers. In this sector, the sales tax will be another factor at work that will influence the pace and features of the further rise of e-commerce.

Subsidies Administered Through the Sales Tax System

Among the consequences of the Great Depression was a crisis in public finance. State governments were both financially pressed and subject to requirements in state constitutions that they balance their budget. From this combination emerged the sales tax. In 1933 alone, twelve states made the decision to impose a general sales tax.

States had long imposed taxes on particular articles (for example, alcoholic beverages.) In contrast to taxes on particular items, the new sales taxes were general taxes that began with the assumption that all sales were subject to tax and particular classes were exempt. By 1950, thirty states had general sales taxes; by 1969, the number was forty-five, where it remains to this day. Alaska has no statewide tax, but some local governments impose a sales tax. Even in states without a general sales tax, there are particular sales taxes. New Hampshire, for example, has a 9 percent rooms and meals tax that functions like a sales tax but is applied only to hotel rooms and restaurant meals that cost thirty-six cents or more.

States that adopted the sales tax also adopted another tax called the use tax. The sales tax applied to purchases of goods within the states. Naturally, states did not want to create incentives for their citizens or businesses to make out-of-state purchases to avoid the sales tax. The use tax addressed those incentives. While sellers would collect the sales tax, responsibility for the use tax belonged to the purchaser who faced the burden of self-assessing the tax obligation and remitting it to the state.

Both the sales and use tax apply to final purchasers. Both businesses and consumers can be final purchasers. Only a portion of purchases by businesses are final purchases. Wholesalers do not pay sales tax on goods they buy from manufacturers to sell to retailers. Wholesalers do pay sales tax on the warehouse trucks and office furniture they buy if those items are subject to the state's sales tax. Manufacturers are in the same position.

The subsidy amount reflects the degree of compliance with the sales tax law. If there are two sellers, one who collects the sales tax and one who does not, the uncollected sales tax is a subsidy that could wind up being split to a varying degree between the buyer and seller. The amount of sales tax creates a wedge between the seller who collects the tax and the seller who does not. What happens to the wedge depends on the relative bargaining power of buyer and seller. At one extreme, the buyer loses the entire wedge to the seller and the seller pockets all of the subsidy. At the other, the seller bargains away the price difference and the subsidy goes to the buyer. Repeated interactions, as between two businesses that have a customer-supplier relationship, offer an opportunity for buyers to get more of the wedge. In "take it or leave it" interactions that individual consumers have with sellers, sellers are much better positioned to hold on to the price difference.

There can be less-than-perfect compliance with state

> Current policy has the effect of giving remote sellers a price advantage, allowing them to sell their goods and services without collecting the sales tax owed by the purchaser. This price difference functions like a subsidy. It distorts the allocation between the two forms of selling.

revenue laws for both in-state and out-of-state purchases. Enforcement studies show that there generally is a high degree of compliance with the sales tax, especially when the buyer, the seller, or both is a large and sophisticated corporation which has a staff that has as its primary task making sure the company complies with the tax laws. Lower levels of compliance occur among less complex businesses. Some failure to comply may be driven by complexity in the sales tax laws. Both types of sales and categories of purchases can be exempt. An examination of the frequency with which a state's sales tax collection agency gets mention in bankruptcy petitions filed by small businesses shows not remitting the sales tax collected can be a form of "desperation finance."

With out-of-state purchases, where the applicable tax is the use side of the sales and use tax, compliance is much lower.[4] Lower compliance reflects differences in specialization between buyers and sellers. As sellers, firms specialize. They have reason to be familiar with the nuances of definitions of which goods and services they sell are subject to sales tax and which are not. As buyers, they are more likely to be buying a more numerous set of goods and services. They must buy both the primary inputs for their product as well as a broad variety of goods and services that allow the firm to do all the things that are ancillary to their primary business. While a manufacturing company's purchases may be dominated by purchases of components for what it manufactures, it also buys cleaning supplies, replacement parts for their vehicle fleet, computers and software, and paper for use in the computer printers.

Compliance also reflects scale. Washington state found smaller firms had higher rates of noncompliance. Large and sophisticated organizations may understand their obligation to pay the tax, but even they suffer from the asymmetry of being in the position of a buyer versus that of a seller.

Individual consumers face the same set of challenges as businesses without the benefit of a tax department to help them figure out the details of use tax compliance. The low degree of compliance with the use tax begins with low levels of awareness that there even is a use tax. It is fed by the burden of compliance. One part of the burden is recordkeeping. Another is applying the correct tax concept to each receipt gathered in the recordkeeping process. For example, a consumer in Rhode Island, a state that imposes a 7 percent sales tax, who

purchases an appliance in Massachusetts, where the sales tax is 5 percent, is obligated to pay the 2 percent difference as a use tax to Rhode Island.

Why is There an Out-of-State Sales Tax Loophole?

When the first states responded to the difficult financial circumstances of the Great Depression by adopting a general sales tax, they recognized that a sales tax on purchases by residents of the state collected by sellers in the state would not reach purchases that their residents made out-of-state.

Their response to out-of-state sales was intellectually cohesive but practically flawed. This response was the use tax. For purchases in the state, the state could designate or create a revenue collection agency that would work with businesses in the state to collect the tax and remit it to the state. Trying to collect from businesses outside the state presented both legal and practical problems. From a legal perspective, it was unclear how a state could position itself to collect in other states. From a practical perspective, a state would be looking at trying to create relationships with a vast number of businesses, many of which would have few or no sales in that state. It would not be cost-effective to find many of the out-of-state sellers.

Thus states adopted a different strategy to collect and remit the tax due on out-of-state sales to their residents. States created a parallel tax to the sales tax called the use tax. Instead of the seller, the use tax would rely on self-reporting by purchasers.

As noted above, self-reporting by businesses does happen. About 10 percent of the revenue collected by state and local government as sales and use tax is use tax. Almost all of it is payments made by businesses. However, estimates of the size of the out-of-state sales loophole suggest that compliance is far from perfect.

The practical challenges of enforcing the use tax from individuals shows that as the compliance cost per unit of revenue increases, revenue is less likely to be collected. To comply with the use tax, a taxpayer faces the burden both of recordkeeping and applying a complex body of law.

Recordkeeping for individual taxpayers who intend to comply begins with a separate shoe box for receipts from out-of-state purchases. Processing those receipts starts with identifying whether the sales tax has already been collected. Those out-of-state sellers who have a physical presence in the buyer's state already collect the sales tax, meaning no use tax is owed. The next step would be to separate which purchases are subject to tax and which are not, a task that requires both knowing the general categories of purchases exempt from tax (in many states, groceries) and the state's revenue rulings over the years that have spoken to whether a particular good or service qualifies under the exemption. For example, is chocolate ordered from an out-of-state specialty company subject to the sales tax?

One approach that has been taken by some of the states is to look for use tax compliance in the income tax return. Twenty-three states that impose both a sales and an income tax try to collect the use tax on the income tax return. Eleven states include something on the income tax return that has to be completed about potential use tax liability. Nine states provide a table which taxpayers can use to find an estimated use tax liability appropriate to the taxpayer's income.

Despite these measures, only 1.6 percent of taxpayers report use tax in the eleven states that make an effort to collect use tax as part of the income tax return. The state with the highest share of returns showing use tax liability is Maine, where 11.3 percent of taxpayers reported use tax obligation on their 2007 tax returns. That may reflect the presumption that Maine had made the use tax liability 4 percent of income if the taxpayer did not report some other amount, a practice which ended in 1999.[5]

Why Don't States Fix the Loophole?

The impracticality of the use tax had fewer consequences when states first adopted sales and use taxes. At that time the largest distortion might have been along state borders. Buyers could order goods from sellers across the state line to be delivered or sent by mail. If the

THE SUPREME COURT AND STATE POWER TO TAX

The commerce clause of the Constitution enumerates authority to regulate interstate commerce as a power of Congress (Article 1, Section 8): "The Congress shall have Power ... to regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." Congress has said little about how states' sovereign power to tax relates to the commerce clause. Federal courts have played a more active role in spelling out the relationship of state sovereignty and state tax power.

In the years before states created general sales taxes, the Supreme Court saw the commerce clause as a source of sharp restrictions on state and local taxes that touched interstate commerce. In the 1880s, the Supreme Court considered a city business license tax imposed on a telegraph company operating under a provision of federal law. The Supreme Court struck down the tax, saying "no State has the right to lay a tax on interstate commerce in any form" (*Leloup v. Port of Mobile*, 127 U.S. 640, 648).

This was the legal context when states adopted general sales taxes beginning in the 1930s. They had to be mindful that the federal courts might say the tax interfered with interstate commerce, so they created a tax on sales to residents of their states, both individuals and corporations, with two sides. With intrastate sales, states required sellers to collect the sales tax. With out-of-state sales, states required purchasers to collect the tax from themselves, naming the tax a use tax.

An early question was the status of the two big retailers who both operated stores and sold by catalog, Sears Roebuck and Montgomery Ward. Did they have to collect sales tax on their catalog sales? In a pair of cases decided in 1941, the Supreme Court held that they did, even though items ordered through the catalog might be shipped from an out-of-state warehouse (*Nelson v. Sears, Roebuck & Co.*, 312 U.S. 359; *Nelson v. Montgomery Ward & Co.*, 312 U.S. 373).

Changes in the marketplace allowed the Supreme Court to consider new types of selling patterns in 1967 in *National Bellas Hess v. Illinois*. National Bellas Hess was a mail order house in Kansas City, Missouri, which specialized in clothing. Unlike Sears, Roebuck and Co. and Montgomery Ward, it did not have stores in Illinois, yet Illinois wanted it to collect the state sales tax. The U.S. Supreme Court looked at the company's relationship to Illinois and noted that it did not have an office, place of business, or telephone listing in that state, nor did it advertise in Illinois newspapers or on Illinois radio or television stations.

National's connection with the state was through mailed catalogs and flyers. That, the Supreme Court decided, was not enough to disturb its bright line defining which sellers could be required to collect the sales tax. Anyone who had a store in a state could be required to collect sales tax on catalog sales. Sellers that did not have physical locations or personnel in a state could not.

seller had no physical presence on the buyer's side of the border, the seller would be unlikely to collect the tax owed by the buyer. The prototypical problem might have been Virginians going into North Carolina to buy furniture. The Virginia address on the invoice would show a North Carolina state tax auditor that no tax was required. Absent voluntary self-reporting by the Virginian who purchased the furniture, Virginia revenue authorities would never know about the purchase and use tax obligation.

As selling technology changed, states made efforts to keep the administration of their tax laws up to speed with those changes. The courts responded to these state initiatives by clarifying what key concepts in the U.S. Constitution implied for administering a sales tax. (See Box opposite: The Supreme Court and Limits to State Power to Tax.)

Catalog sales raised a range of issues. A decade after states began to impose general sales taxes, the Supreme Court decided that sellers who both had stores and catalogs could be required to collect sales tax on catalog sales, even when the merchandise was shipped from out-of-state and not the in-state store. The Court has hewed to the view that a seller must have a store or other physical facility in a state before the seller can be required to collect the state's sales tax, affirming its position in *National Bellas Hess v. Department of Revenue*, 386 U.S. 753 (1967) and *Quill v. North Dakota*, 504 U.S. 298 (1992), both cases that involved catalog sellers.

The Supreme Court decisions have been the work of one branch of the federal government to preserve federal prerogatives. The Court has noted that the legislative branch might also set policy on whether requiring out-of-state sellers to comply with state sales tax laws is an undue burden on interstate commerce. As the Court wrote in its *Quill* decision, "Congress is now free to decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes."

Since the 1992 decision, new possibilities have emerged. In addition to selling through stores and catalogs, sellers have an additional hybrid strategy, offering consumers a choice of buying at a physical store or online. These hybrid sellers have no choice but to collect the sales tax on their online sales.

When companies that sell remotely have acquired physical presence in more states, they lose their ability to ignore the sales tax in those states. The Sears purchase of Lands' End offers an interesting example of what current federal policy implies. Before being bought by Sears, Lands' End had a small physical footprint, focused on one state: Wisconsin. However, its new parent, Sears, has stores in every state. The result is that Lands' End now collects the sales tax on behalf of all the sales tax states.

Circuit City Stores shows one more possibility: leaving selling through stores and selling only through the Internet. Following Circuit City Stores' bankruptcy and subsequent liquidation, an entrepreneur purchased the rights to the Circuit City name, allowing for the resurrection of Circuit City as an online-only seller. In its new form, CircuitCity.com is liberated from the burden of collecting sales tax for states other than where it has a distribution center.

Future Directions in the Technology that Bring Together Buyers and Sellers

From the perspective of the 1990s, the possibilities of buying and selling that have become available would be surprising. Time of day and distance from seller have become irrelevant constraints. No doubt the world of twenty years hence will bring its own surprises in the technologies that bring together buyers and sellers.

Physical limitations will remain important in many categories. Sales at gasoline stations, which were just under 10 percent of all retail sales in 2009, offer an example of how physical limitations will limit change. Gasoline's weight relative to its sale price and the scale economies in transporting it by tanker truck make it unlikely to be something that would ever be sold remotely, at least in the volumes bought by the typical household. Remote sellers would find it difficult to match a characteristic consumers value about the non-gasoline items sold by gas stations: immediate availability.

Standard setting for products sold "business to business" long preceded the rise of information technology and the possibilities that opened for remote selling.

> No matter whether a sale occurs face-to-face or remotely, the information technology supporting any transaction is more capable today than it was a generation ago.

There are many possibilities on the consumer side that technology has not yet reached but could.

Some possibilities:

- **Clothing.**

More standard setting and more parameters in standards. Men's shirts are available not just in Small-Medium-Large but also in two-parameter sizing: neck and sleeve length. Multiple parameters, combined with computer-controlled made-to-order processes, could tilt more of the clothing market towards remote purchases.

Technologies that combine pictures of individuals with particular clothing styles, fabrics, or colors could increase the sensory richness of the online shopping experience.

- **Sensor-driven purchasing.**

Refrigerators and home pantries can be equipped with sensors using RFID tags that track household inventories. Consumers could set inventory alerts that could also be set to access the Internet and automatically order more when supplies run low. While many grocery items are exempt from sales tax in many states, other kitchen items (e.g., plastic bags) are not.

Reducing the Burden of Compliance

Since the Supreme Court last stated federal policy on sales tax compliance, in the 1992 *Quill* decision, advances in information technology have reduced the burden faced by sellers who must already collect the sales tax for multiple states.

Regardless whether a sale occurs face-to-face or remotely, the information technology supporting any transaction is more capable today than it was a generation ago. Compared to the real-time analytics applications used by the most sophisticated sellers, the software module required to determine if a sale is subject to sales tax and calculate the correct amount is trivial. A seller which does not have some information technology supporting

the sales process is rare. Sellers can turn to either customized applications or off-the-shelf software that can calculate the sales tax for any jurisdiction in the country. They can also turn to third parties to do compliance for them. For example, Amazon will collect sales taxes for all jurisdictions for those who use Amazon to sell as Amazon Marketplace clients for a 2.7 percent fee.

Choices made by state and local governments add to the burden of complying with the sales tax. Rates can change at any time of the year. A city or county government can subject different items to tax or exempt certain items.

Policy Options

Many tools could be put to use to implement approaches that would make the future marketplace a fair one in which tax policy does not distort sales away from the most efficient location.

They differ along several dimensions, including:

• **Federalism**. Some options have no role for the federal government, relying on state action. They include leveling the playing field down and reducing the range of goods subject to the sales tax.

Other options involve federal pre-emption or a new bureaucratic role for the federal government. Moving to an origin-based sales tax, for example, would require federal pre-emption of state laws and an ongoing federal role to administer the sales tax, as would a national "e-commerce sales tax" as an alternative to collecting the sales tax of the state where the consumer is located.

• **Degree of change**. Some options involve incremental change and others involve radical departure from current practices. Ending the general sales tax on categories of goods which are most likely to be sold remotely leaves the general structure of the sales tax in place and adds to the current list of exemptions. Shifting from a destination-based to an origin-based sales tax would be a large conceptual change in what the sales tax is, from an approximation of a consumption-based tax to a tax on business transactions.

1. Reduce the Scope of the General Sales Tax.

The playing field could be leveled between in-state and out-of-state up or it could be leveled down. State and local governments could look at the potential for remote selling and apply the general sales tax only to goods and services which are not likely to be sold remotely.

Some states accomplish this already on a time-limited basis through sales tax holidays. These holidays allow purchase of some goods with no sales tax for a certain period of time. "Back-to-school" purchases of clothing are an example.

Pro

—Creates a level playing field for sellers in different states.

—Provides a rationale for cutting taxes.

Con

—The long-term trajectory of the sales tax has led to a tax base which is a smaller and smaller share of the economy and upward rate creep. This would add to pressure for higher rates on goods subject to tax.

—Allows a loophole to drive tax policy.

2. Get Rid of the Use Tax on Purchases by Individuals.

Only a small share of people make an effort to comply with the use tax. Ending the tax on purchases by individuals would end the status of a use tax on out-of-state purchases by individuals as a legal fiction.

Pro

—Compliance costs are large relative to amount owed.

—Individuals pay only a small share of use tax receipts. Eliminating the legal liability for use tax would mean only a trivial loss of state revenue.

Con

—In-state and out-of-state purchases would continue to have different treatment under state sales tax laws.

—Treats purchases of the same goods by individuals and businesses differently, as businesses would continue to pay the use tax.

3. Close the loophole.

Congress could accept the invitation from the Supreme Court to articulate a standard for an undue burden on interstate commerce. The simplification framework developed by the states in the Streamlined Sales and Use Tax Agreement offers an example of a standard that Congress could endorse.

Pro

—Gives same treatment to purchases from in-state and out-of-state sellers.

—Does not require an ongoing federal role in the sales taxes imposed by state and local governments.

Con

—Requires congressional action.

—Without a "smaller seller exemption," compliance burden relative to amount of tax collected would be relatively higher for some sellers.

1992: THE MOST RECENT WORD FROM THE SUPREME COURT

A quarter-century after the *National Bellas Hess* case, the Supreme Court returned to the same issues in *Quill v. North Dakota*. The Court affirmed its bright line test, requiring some physical connection between a state and a seller—some kind of physical premises in the state or employees based in the state—before a state could require the seller to collect the state's sales tax.

North Dakota had amended its definition of a seller who must collect the state's sales tax to include "every person who engages in regular or systematic solicitation" of business in the state. Quill was then a catalog seller, selling office supplies via printed catalogs mailed to businesses in North Dakota and other states. It had warehouses in Illinois, California, and Georgia. It had no facilities in North Dakota, nor did it have any employees there.

The state supreme court argued that "the tremendous social, economic, commercial and legal innovations" since the Supreme Court had decided the *National Bellas Hess* case in 1967 meant that the decision was obsolete.

The U.S. Supreme Court differed. The bright line in *National Bellas Hess* would remain its standard for interpreting the commerce clause. And as a result, North Dakota could not require Quill to collect the North Dakota sales tax on office supplies shipped to North Dakota.

The court noted that "like other bright line tests, the *Bellas Hess* rule appears artificial at its edges," but it established clear boundaries. Since Congress had not spoken, the Supreme Court would.

The court pointed to Congress to provide more guidance, noting 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."

At the time, the idea of a graphical user interface and a world wide web were less than three years old and the web accounted for less than 1 percent of Internet traffic.

The world has changed, not only for the marketplace, but for Quill itself. Quill no longer benefits from the Supreme Court's affirmation of its position. The company was acquired by Staples in 1998 and continues today as Quill.com. Because Staples has physical stores across the country, Quill.com now collects sales tax on sales to all states, including North Dakota.[1]

[1] Staples 2010 Annual Report, [illegible]

NOTES

1. Thirty-one states and the District of Columbia exclude food purchased for home consumption from their sales tax; seven tax food but at a lower rate than the general sales tax; five tax food but offer a tax credit for lower-income households meant to offset part or all of the tax; two tax food at the same rate as all other purchases. Center on Budget and Policy Priorities, "Which States Tax the Sale of Food for Home Consumption in 2009?," Washington: 2009. http://www.cbpp.org/cms/?fa=view&id=1250

2. U.S. Census Bureau, "Quarterly Retail E-Commerce Sales 3rd Quarter 2011," CB11-186, November 17, 2011 http://www.census.gov/retail/mrts/www/data/pdf/ec_current.pdf. The Census Bureau defines retail sales by the nature of the seller, not who buys, thus this definition includes both business-to-consumer sales as well as some business-to-business sales. E-commerce is one part of remote sales by out-of-state sellers which also includes catalog sales and calls to toll-free numbers spurred by radio and television advertising and direct mail. The Census Bureau data also do not break down e-commerce sales between in-state sellers who are already required to collect the sales tax and out-of-state sellers who are not.

3. U.S. Census Bureau, "E-Stats," May 26, 2011. www.census.gov/econ/estats/2009/2009reportfinal.pdf

4. The State of Washington Department of Revenue looked at compliance in a sample of audits in conducted between 2005 and 2008. The audits covered returns of excise taxes collected by businesses. It found sales tax compliance was 99 percent: that is, the amount remitted was 99 percent of tax liability. Use tax compliance was 77 percent. State of Washington Department of Revenue, "Department of Revenue Compliance Study," Department of Revenue Research Report #2010-4.

5. Nina Manzi, "Use Tax Collections on Income Tax Returns in Other States," Policy Brief, Research Department, Minnesota House of Representatives, June 2010.

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Origin-Based and Destination-Based Sales Tax Models

A sales tax can be either origin or destination based. In the origin-based model, the tax is the tax rate and rules in the seller's location, and in the destination-based model, the tax rate and rules are those in the buyer's location. This report compares the two models.

The differences between the two are both conceptual and practical. In the United States, the key conceptual differences involve federalism. In the destination-based model, the federal government's role is, at most, to give consent to state collaboration. In the origin-based model, the federal government must pre-empt state sovereignty to ensure that states comply with the model.

The impact of moving to an origin-based model

The main body of this paper compares the *concept* of the destination- and origin-based models for a state-imposed sales tax. What the United States has today reflects state decisions to adopt the destination-based model for sales across state lines.

Thus, two comparisons can be made. One is between the two concepts, origin based and destination based. The other is between the world we have (destination based) and the world we would have if the United States moved to an origin-based tax. While the rest of this paper compares the concepts, this section compares the practical implications of moving from the destination-based model already in place to the origin-based model.

With the current destination-based sales tax, each state sets its own sales tax rate. Five states have a 0 percent sales tax (Alaska, Delaware, Montana, New Hampshire, and Oregon). Residents of these states, unlike the residents of other states, do not face a "use tax" on purchases made from out of state. States impose a use tax on goods used, stored, or consumed in the state where tax has not been paid through the sales tax. Most use tax applies to purchases made from out of state. While sellers collect sales tax on behalf of purchasers, buyers are responsible for making use tax payments. For purchasers in states without a sales or use tax, both in-state and out-of-state purchases are free of state sales tax.

For residents of the no-sales-tax states, the origin-based sales tax would be a new tax. Under an origin-based system, residents of these states would begin to pay sales tax when making purchases from out of state. A resident of Montana, for example, who previously had no obligation to pay a sales or use tax on merchandise ordered over the Internet from a seller in Indiana, would now pay the 7 percent Indiana state sales tax.

For residents of the states that currently have a sales tax, the origin-based tax would mean a continuing obligation to pay sales tax, but at a different rate. Consider the case of buyers and sellers in Kentucky and Tennessee. Kentucky has a 6 percent sales tax; Tennessee's average rate is 9.45 percent (this includes the state's 7 percent sales tax and the average local rate of 2.45 percent, as calculated by the Sales Tax Clearinghouse, http://thestc.com/STrates.stm). For Kentucky residents, the origin-based sales tax would mean a tax increase on purchases from Tennessee. For Tennessee residents, it would mean a reduction in sales tax for purchases from Kentucky.

Features and Incentives

The origin- and destination-based approaches are substantially similar when buyer and seller are in the same state or in different states with the same sales tax rate. In these cases, the sales tax rate is the same under both models. The two approaches can have different results when buyer and seller are in different states with different sales tax rates.

The different rates mean a difference in price for the purchaser, and in a market system, buyers respond to such differences. This price difference reflects tax policy, not differences in input costs or efficiency. Table 1 compares the mechanics and features of the two models.

The economic analysis of taxation describes tax laws that lead to a change in behavior to be examples of how tax policy produces distortion and loss of economic efficiency. The price is different not because one seller is more or less efficient, but because the seller is located in a state with a higher or lower sales tax rate.

Students of political economy see differences in tax rates as an opportunity for tax competition between governments. If the difference in tax rates is large enough, or purchase decisions sufficiently sensitive to price differences, purchasers will switch to sellers in a state with a lower sales tax rate. Sellers who thereby lose sales have an incentive to mobilize to encourage their state to lower its tax rate on the product or service they sell.

The range of responses to political pressure to lower a state's sales tax in an origin-based model includes:

- Lower the sales tax on all goods and services to which the sales tax applies.
- Lower the sales tax on those goods and services that can easily be sold across state lines, but leave the sales tax unchanged on goods and services that cannot easily be sold across state lines (such as restaurant meals).
- Make strategic moves to export the state's sales tax burden. In a political economy model, rational state politicians seek to export the tax burden to citizens of other states and countries. This allows politicians to deliver political rewards without imposing costs on their electorate. An example of this behavior is New Hampshire's rooms and meals tax, an exception to New Hampshire's "no sales tax" stance, but a tax more likely to be paid by those from out of state than a general sales tax. An origin-based sales tax would create a new means for politicians to export the tax burden to residents of other states. Politicians would face incentives to try to leverage the strength of companies in their states. For example, Washington State, which has a sales tax but no income tax, could remove exemptions for capital goods to tap the substantial out-of-state and out-of-country sales of Microsoft and Boeing. While the risk that businesses would leave the state would temper state efforts to tax goods sold out of state, voters would otherwise prefer tax regimes that export the tax burden to taxpayers in other states and countries.

The analysis up to this point has assumed that there is no cost to moving goods and services across state lines. Distance between buyer and seller and the nature of the product tempers the impact of sales tax differences. The impact is greater where the sales tax difference has a greater influence on total cost. For some products, such as sand and gravel, additional shipping costs would outweigh sales tax savings, but sales tax differences would have a larger impact on the sale of luxury goods, for example, where shipping is a smaller share of total cost.

Table 1. Mechanics and Features of Origin- and Destination-Based Models

	Origin Based	Destination Based
Tax rate	Tax rate in effect in the *seller's* state. Buyers may owe use tax to their state (depending on scope of federal pre-emption.)	Tax rate in effect in the *buyer's* state.
What is taxed	Follows rules in the seller's state.	Follows rules in the buyer's state.
Tax diversity: one state taxes a product/service, the other does not	If taxed in seller's state but not buyer's state, seller pays tax. If taxed in buyer's state but not seller's state, buyer may owe use tax (depending on scope of federal pre-emption).	If taxed in seller's state but not buyer's state, no tax collected by seller and no tax owed by buyer. If taxed in buyer's state but not seller's state, no tax collected by seller but buyer may owe use tax.
State receiving tax revenue	Seller's state receives sales tax amount. If federal pre-emption does not prohibit use tax, buyer's state may require use tax, thereby producing revenue for buyer's state through double taxation.	Buyer's state receives sales tax amount.
Use tax	Uncertain. If not pre-empted by federal law, could be used to counter incentives to buy out of state.	Neutralizes incentives to buy out of state.
Imports	Not taxed.	Taxed at rate of buyer's state and according to rules of that state.
How states could not cooperate	Impose use tax on out-of-state sales.	Impose origin-based sales tax.
Impact of not cooperating	Double taxation on purchasers in state.	Double taxation on sales to out-of-state buyers.

Use Tax

Each state with a destination-based sales tax imposes a use tax on purchases made from sellers who do not collect the state's sales tax. The use tax neutralizes sales tax differentials. Whether the purchaser buys from an in-state seller or out-of-state seller, the tax rate is the same. While sellers collect the sales tax, the use tax requires purchasers to assess the tax, file returns, and remit the tax. Compliance by individuals is low. Compliance by businesses is much higher.[1]

In an origin-based model, a state that continued to impose a use tax would undermine the sales tax differential. The tax benefit to a buyer who makes a purchase from a seller in a state with a lower sales tax or no sales tax would disappear if there were a use tax. At best, the use tax would neutralize the sales tax differential, allowing the location neutrality of the destination-based sales tax to persist. This would occur only where the seller's state had no sales tax or no tax on that item or service. If the seller's state imposed an origin-based sales tax, purchasers in use tax states would face a higher overall tax rate because they would pay both the seller's state's sales tax and their own state's use tax. Thus, without federal pre-emption of state use taxes, the origin-based model would allow states to exploit the use tax to create incentives to buy in state.

Individual consumers would be unlikely to be affected by the disincentive because they have low rates of use tax compliance. However, corporations, and especially larger corporations, which comply at a higher rate than individuals, would be more likely to act on the incentive to buy in state under an origin-based model that allowed states to continue to impose a use tax.

Imports

Under the origin-based model, no state sales tax would be due on imports, as their origin is outside any state.

In the European Union, the Value-Added Tax (VAT), imposed by all EU members, is generally destination based for imports to each country ("distance sales"). For sellers who do relatively small amounts of business in a particular country in a given year—most commonly up to €35,000, or $45,500—the tax is origin based.[2] For imports, which are analogous to "remote sales" or sales from sellers in one European country to buyers in another, the European Commission's VAT Directive requires EU countries to impose the VAT in the country where the good arrives. This is not necessarily the country through which the good first enters the EU. For example, goods that enter the EU through Poland but are destined for the Netherlands are taxed in the Netherlands.[3]

The United States could impose an origin-based sales tax for domestic sales and a destination-based sales tax for imports. However, administering two systems at the same time would increase the burden and complexity of tax compliance. An advantage of moving to the origin-based model, which frees buyers from compliance obligations, would be lost, as buyers would still have to maintain records to comply with tax obligations on imports.

A federal sales tax on imported goods is one way to keep imports from escaping any sales tax under the origin-based model. The tax rate could be the average, tax-base-weighted sales tax rate across all states with sales tax. Receipts from the federal sales tax could be distributed to states and localities in proportion to their volume of domestic sales. A new bureaucratic structure would be required to

administer the federal sales tax, as would a new federal policy on what goods are subject to sales tax and what are exempt. A large share of imports are for resale, a category usually exempt from state sales taxes, and thus there would be a large amount of paperwork involved in filing exemption certificates, relative to the amount of tax revenue.[4] Policymakers might thus decide that the compliance cost is too high, and imports might remain untaxed.

Fiscal Federalism

The origin- and destination-based models are two models of fiscal federalism. Each requires different roles for the federal government.

As Table 1 shows, the two models create different incentives for states to cooperate. The origin-based model can be undermined by a state that imposes a use tax. Undermining the destination-based model would mean adopting an origin-based sales tax. This would make goods and services more expensive in destination-based states, as buyers would pay both the origin-based sales tax of the seller's state and the destination-based sales tax of the buyer's state. States have no incentive not to cooperate with the destination-based model, which, unlike the origin-based model, is self-reinforcing. Given that historical forces produced a destination-based sales tax in the United States, this explains why no state has moved to an origin-based sales tax. The origin-based model requires an outside force—the federal government—to force state cooperation.

In the destination-based model, the federal government has at most a coordinating role, giving its consent to state efforts to cooperate. An origin-based model requires federal pre-emption of state sovereignty.

Because sales taxes in the United States came about as state initiatives, their features reflect decisions made by states at the time they were adopted. Tax competition had implications for the design of the first general state sales taxes. (Kentucky and Mississippi appear to have been the first states to impose a sales tax, in 1930).[5] Had Mississippi, as a pioneer, adopted an origin-based sales tax, it would have disadvantaged Mississippi businesses.

Consider what would have happened to an office supply dealer who operated in northern Mississippi, just south of Memphis, if Mississippi had opted for an origin-based sales tax. The dealer's customers in Memphis would have begun to see the Mississippi sales tax on their invoices. Market forces would have meant two choices for the supplier: either reduce his prices below the price charged by Tennessee-based suppliers, or lose the sale to them. If the market was competitive, meaning prices had been pushed down to the cost of inputs, lowering prices would have meant losing money on Tennessee sales. The market would have told the Mississippi supplier to stop selling in Tennessee. In either case, reducing prices or stopping sales, the result would have been the same: the origin-based sales tax in Mississippi would have meant lower sales by Mississippi firms to buyers in Tennessee.

This example shows the nature of the choices states faced in the early days of state-level sales tax. Any state that adopted an origin-based sales tax would have disadvantaged in-state businesses. (While economic models often say that going first brings an advantage, there would have been a "first mover disadvantage" in this case.) Thus, the process by which the state-level sales tax began in the United States, as a series of individual decisions by states acting alone, explains why they opted for a destination-based, rather than an origin-based sales tax.

For the same reasons that states did not adopt the origin-based model originally, a state that changed to such a model would disadvantage itself unless it could convince all other sales tax states to change at the state time. The states' self-interest reinforces the existing destination-based model and helps explain why no state has changed from the destination- to the origin-based model.

Federal pre-emption could require all states that all sales tax states use the origin-based model. This step would be subject to constitutional challenge in the federal courts. The claim that the federal government has the constitutional authority to require state sales taxes to be origin based requires an expansive interpretation of the commerce clause. There would be little economic activity beyond the federal government's reach under a reading of the commerce clause that allowed the federal government to dictate the terms of a tax within a state.

A federal law that pre-empted state authority to impose destination-based sales taxes would also have to decide the fate of the use tax. Without federal pre-emption of use tax authority, states could undermine the potential for tax competition in the origin-based system. They could do this by imposing a use tax on all out-of-state purchases, subjecting them to double taxation, or by imposing a use tax when the seller's state has a lower sales tax rate, which would bring the rate paid by the purchaser up to the rate in the purchaser's state. Table 2 summarizes the federalism implications under the two sales tax approaches.

Table 2. Fiscal Federalism Issues in Origin- and Destination-Based Sales Taxes

Issue	Origin Based	Destination Based
Federalism burden	Pre-empt state law.	Historically, none. Federal consent required to allow states to impose tax collection obligation on remote sellers.
Federal government's role	Define key terms such as "origin." Possible role in collecting sales tax on imports.	None.
Incentives	Buy from the state with lowest tax. Incentive to buy in state if state has use tax. Incentive to buy foreign products, not domestic, if no sales tax on imports.	Neutral, if use tax is collected. Incentive to buy out of state with imperfect use tax collection.

Tax Competition

Inherent in the origin-based model is the potential for economic competition between states based on sales tax differentials. The destination-based model, on the other hand, produces no tax competition: the combination of sales and use taxes means that it makes no difference to the buyer whether purchases are made in state or out of state.[6] The buyer pays the in-state sales tax rate on in-state sales and the same rate, through the use tax, on purchases made from out of state.

Under the origin-based model, the sales tax rate in the seller's jurisdiction becomes one of the factors that influence the buyer's decision. Everything else being equal, a buyer will prefer to buy from a seller in the state with the lowest origin-based sales tax.

As noted earlier, many factors can keep everything else from being equal. Transportation costs can offset sales tax savings for some purchases. Purchases of heavy or bulky products, whose transportation costs are a large share of total costs, are less likely to be influenced by sales tax differentials.

States could act strategically to counteract sales tax differentials, though this would depend on the scope of federal pre-emption of their ability to design the features of their sales tax. A state with a relatively high sales tax rate could decide to have a lower tax or no tax on goods whose shipping cost is a small share of total price, but maintain its sales tax on other goods and services. Clothing might be an example. (States already engage in this category-specific competition through sales tax holidays, such as no sales tax or reduced sales tax on clothes during the back-to-school season.) Strategic responses could leave the state's general sales tax rate unchanged but provide more numerous exemptions.

Exempt Sales Compliance

Moving from a destination-based to an origin-based sales tax would mean shifting the compliance burden for exempt sales. States exempt classes of business-to-business sales to avoid having a "tax on a tax" as goods move to final consumers, which would occur if goods were taxed at the time of wholesale sale and again at retail. For example, sales for resale, such as by wholesalers to retailers, are exempt. The shift would mean a new compliance burden for those who make exempt purchases across state lines. Under the destination-based model, purchases from remote sellers, that is, sellers in other states, are not taxed at the point of sale. Rather, they are taxed by charging the purchaser a use tax. With sellers collecting sales tax on all sales of goods subject to tax, purchasers would have to file sales tax exemption certificates with all sellers, not just those who are in state. If business purchasers did not file the exemption certificate, they would find themselves paying sales tax on a previously untaxed sale. Either result would represent a new burden on businesses that buy from out-of-state sellers. Table 3 shows how sales tax and use tax is collected for consumer and businesses purchases.

Table 3. Sales and Use Tax Collection: Consumer and Business Purchases

Destination-Based Model

Consumer Purchases		Business Purchases	
		Non-Exempt Purchase	Exempt Purchase
Same-state sellers	Seller collects.	Seller collects.	Buyer presents exemption certificate.
Out-of-state sellers	Buyer pays use tax.	Buyer pays use tax.	None.

Origin-Based Model

Consumer Purchases		Business Purchases	
		Non-Exempt Purchase	Exempt Purchase
Same-state sellers	Seller collects.	Seller collects.	Buyer presents exemption certificate.
Out-of-state sellers	Seller collects seller's state's tax.	Seller collects seller's state's tax.	Buyer presents exemption certificate.

Origin-Based and Destination-Based Sales Tax: Trade-offs

Moving from a destination-based sales tax to one that is origin based brings trade-offs. Some problems get solved, others created.

Many of these problems result from federalism: each state setting its own rules adds complexity. The only way to simplify the sales tax is federal action—harmonizing a destination-based sales tax through an agreement such as the Streamlined Sales and Use Tax Agreement—or an assertion of federal authority involving a move to an origin-based tax.

Forty-Five State Rules. A destination-based sales tax places the burden of tax variations from state to state on sellers in the forty-five states with state sales taxes. A seller must know what is taxed in one state but not another.

A move to an origin-based sales tax would relieve sellers of the burden of being familiar with the rules that determine the sales tax base in each of the states where they have customers. As the highlighted cell in table 3 shows, it would also create a new burden on businesses buying across state lines, which would be required to show that they are exempt from the other state's origin-based sales tax. This would require knowing the nuances of what is and what is not an exempt sale in each of the states where the buyer makes purchases.

Location. Tax differences can fuel economic development. Locations with lower tax rates are rewarded with more economic activity, more jobs, and more investment.

With an origin-based sales tax, sellers who do business in multiple states might have flexibility to choose their origin state. For example, many corporations have Delaware—which has no sales tax—as

their corporate domicile, the state in which they are incorporated. If sellers were free to name the state of origin, many would name a no-sales-tax state such as Delaware without having to change the physical location of any economic activity. The result would be large changes in where sales originate for sales tax purposes.

The location problem has two possible solutions. One is to allow sellers who do business in multiple states to choose the state of origin for out-of-state sales. The other is to impose "rules of origin." To be workable, rules of origin would have to be nationally uniform. If each state had its own, sellers could be subject to multiple states' sales taxes on the same sale. For example, if one state said that the shipping warehouse was the origin and a second said that the origin was the state where the product was made, a seller could be subject to origin-based sales taxes in both states.

An authority that had the ability to coerce recalcitrant states would be required. Some part of the federal government could be given responsibility to define rules of origin. An alternative would be a federal law that required states to follow rules set by some entity outside the federal government, either a new, single-purpose organization or some existing organization designated to set such rules.

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[1] An estimate of state use tax compliance by businesses comes from the state of Washington, which estimated that use tax paid equaled 74.5 percent of use tax owed. State of Washington Department of Revenue, "Department of Revenue Compliance Study," Research Report 2008-5, accessed March 7, 2012, http://dor.wa.gov/Docs/Reports/Compliance_Study/compliance_study_2008.pdf. Three investigators at the University of Tennessee, lacking a similar study for individual compliance, assumed a compliance rate of 5 percent. Donald Bruce, William F. Fox, and LeAnn Luna, "State and Local Government Sales Tax Revenue Losses from Electronic Commerce," April 13, 2009, http://cber.utk.edu/ecomm/ecom0409.pdf.

[2] See the column for "Threshold for Application of the Special Scheme for Distance Selling," in European Union, "Annex 1: Thresholds (March 2012)," accessed May 8, 2012, http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/traders/vat_community/vat_in_ec_annexa.pdf.

[3] European Commission, "Where to Tax?" accessed March 8, 2012, http://ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/vat_on_services/index_en.htm.

[4] Consumer goods are 22.9 percent of imports; larger categories are industrial supplies and materials (including crude oil and gasoline) and capital goods. "Imports of Goods by End Use Category and Commodity," in US Department of Commerce, "US International Trade in Goods and Services, December 2011," released February 12, 2012. A large share of consumer goods are likely imported for wholesale, not directly for consumers or businesses as "final sales," and thus they would likely not be subject to sales tax.

[5] William F. Fox, "History and Economic Impact," March 13, 2002, accessed March 7, 2012, http://bus.utk.edu/cber/staff/mmnecon338/foxipt.pdf.

[6] It could be argued that the administration of the sales tax creates an incentive for out-of-state purchases through imperfect enforcement of the use tax. However, imperfect enforcement is not competition between specific states, only competition between buying in state and out of state, regardless of where the out-of-state seller is. Also, there is limited competition, again through imperfect enforcement of the use tax, where an individual is willing to travel to a lower tax state to make a purchase. The cost of doing so is low for those who live along state borders but high for those who live far from a border with a lower (or no) sales tax state. Vermonters and suburban Bostonians can readily get to tax-free New Hampshire; those who live in San Francisco have a long way to go to get to Oregon.

BACKGROUND: Why is the sales tax model an issue?

The sales taxes imposed by American states follow the destination-based model. This fact reflects how the sales tax arose in the United States.

While states had long taxed particular goods, they adopted general sales taxes applicable to broad classes of sales as a response to the fiscal crisis during the Great Depression in the 1930s. The structure of these taxes reflected the federalism of the US Constitution. While states have sovereign power to impose taxes within the state, the Constitution's commerce clause constrains state sovereignty. (Article I, Section 8 enumerates the powers of Congress, among which is "to regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.")

In structuring their sales taxes, states deferred to the federal government's power over commerce across state lines, imposing a sales tax on residents of the state and requiring sellers in their state to collect the tax. For sales from out-of-state sellers, states placed the burden of collecting and remitting the tax on buyers and called it a "use tax."

Litigation soon asked the federal courts to clarify who had to collect sales tax. In the earliest cases, the courts interpreted the commerce clause to mean that states could not require out-of-state mail order catalog sellers to collect the sales tax due on sales to state residents unless the mail order company also had a physical presence in the state. This meant that Sears, Roebuck & Co. and Montgomery Ward could be required to collect sales tax on catalog sales in all the states where they had stores, even if the goods were sent from an out-of-state warehouse.

More recently, the possibilities for remote sales have expanded far beyond mail order catalogs to include 1-800 numbers, direct electronic data interchange between buyers and sellers, and the Internet. The judicial branch's interpretation of the commerce clause has meant that states cannot require sellers who use these new methods of remote sales to collect the state's sales tax unless the remote seller has a physical presence in the state.

Since 1999, a number of states have worked through the Streamlined Sales and Use Tax Agreement (SSUTA) to simplify sales taxes. They want Congress to retain the destination-based sales tax and to give them the ability to require out-of-state sellers to collect their (destination-based) sales tax on sales to their respective states.

The origin-based sales tax model offers an alternative approach. In this model, the tax would be owed not by the purchaser, but by the seller, who would collect the sales tax that applied in his state. The tax would be imposed both on taxable sales to buyers in the same state as the seller and buyers who lived in other states (as, for example, with Internet sales.)

In the origin-based model, the sales tax is a tax on sales made by the seller. In the destination-based model, the sales tax is a tax on purchases made by the buyer and collected by the seller.

Mr. COBLE. Without objection. You may continue, Mr. Kuttner.

Mr. KUTTNER. Thank you. I am reminded as I thought about this today about Charlie Schultze, who had been the Chair of the Council of Economic Advisers in the Johnson administration, and Schultze said that it was very simple to be an economist in the Federal Government, which was you just leaned forward every so often and say marginal cost, remember marginal cost. Well, my little contribution today is to lean forward and say remember the declining cost of information and the cost of gathering information and putting information together and making information useful.

In this area that you are looking at today, information is described by the world of 1992 when the *Quill* decision was rendered, a time when there weren't any smartphones and looking something up meant getting out some paper document and turning to a particular page and having your fingers run down the column.

In talking about the issues that you are looking at today with one of my most junior colleagues at Hudson, he said to me, Well, why just can't you Google that or why isn't there a smartphone app for that? And so that is the world, how much the world has changed since 1992. And the thing I would lean forward and remind you is that information's cost is declining, and that is going to both change this marketplace and change the challenge of what does it mean to be an undue burden in this area.

Thank you.

[The prepared statement of Mr. Kuttner follows:]

Statement of

Hanns Kuttner

Visiting Fellow
Hudson Institute

before the

House Committee on the Judiciary

on

HR 3179, "Marketplace Equity Act of 2011"

July 24, 2012

I'm Hanns Kuttner, a Visiting Fellow at Hudson Institute. From Hudson's founding in 1961, it has been an organization of people with an interest in the nature of the future. I appreciate this opportunity to offer a perspective on the future of buying and selling.

Within the past year we provided a view of the future of buying and selling with a focus on issues that relate to today's hearing: how advances in technology will change the role of place in where buyers and sellers are located. We gave this report the title, "Future Marketplace: Free and Fair" because that title reflects how technology and the sales tax are one force giving shape to the future of the marketplace.

Before turning to some of the details of the report, let me start with a discussion of innovation, something that might be seen as a digression, but to me is essential to understanding the issues you are sorting through.

Innovation is the source of improvement in our standard of living. We live different lives than those who came before us because of innovations in technology and how technology gets put to use.

In the late 1960's, Herman Kahn, who founded the Hudson Institute, along with Hudson colleagues, published a look at the future entitled, "The Year 2000: A Framework for Speculation on the Next Thirty Three Years." Now that it is past the year 2000, we have the ability to look back and see what they got right and what didn't turn out as they expected. They made it easy to assess their work by including a list of 100 innovations they thought possible.

Looking over the list, the ones that were most likely to be realized were those that had to do with communications and information technology. "Personalized pagers" have both come about and been surpassed. Similarly with "home computers." Those that have not turned out as expected are in such categories as energy and transportation.

One thing I see in looking at the list of innovations realized and not is how important changes in relative prices are for innovations that have come about and those that have not.

The whole world of information technology and its role in our economy is overshadowed by Moore's Law. When first propounded in the 1960's, it expressed a relationship between the number of transistors on integrated circuits and the time it takes to develop a circuit with twice as many transistors. For our purposes, what is important is the impact on prices. When you can double capacity without increasing price, there is a strong effect on relative prices. Whatever gets made cheaper, you'll buy more of; what's been made relatively more expensive, you'll buy less.

The areas where the possibilities seen in the late 1960s have been realized have been those where the changes in relative prices have been the greatest. We got the "personal pagers," and a lot more. We didn't get the innovations in sources of energy because changes in relative prices have not occurred. Had improvements in solar collectors occurred at the same pace as integrated circuits, we would have been more likely to be a world in which solar power dominated electricity generation.

Developments in technology determine what is possible; changes in relative prices determine how extensively those technologies get used.

Today I can use a search engine to find more references in a second than I could in a whole year in a library a generation ago. I used Google to search for "relative prices" and got 714,000 results in .45 seconds. And the cost to me was free. Lewis Strauss, who chaired the Atomic Energy Commission in the 1950s, got it right with his formulation that the children of that generation would experience a world with something that would be "too cheap to meter," except it would turn out to be information, not electricity.

It is change in relative prices which is behind the degree to which we adopt new technologies. Many generations of integrated circuits ago, a smart phone would have cost $2,500 rather than a tenth or less of that price. At that price, many fewer people would have adopted this technology.

Were my Hudson colleagues and I to revisit Herman Kahn's 1967 project and offer our musings about the world 33 years hence, many of the possibilities would no doubt embody an element of information technology. While one reason to do that would be seeing the potential for new technologies, the more important reason would be changes in relative prices. Technology that involves information will be both quicker and faster, but more importantly, cheaper.

Concepts that require vast amounts of information are at the core of many of the most interesting innovations of our time. The challenge for thinking about what might be possible in the future is thinking through how those vast amounts can be put together in a way that users find simple and attractive.

This brings me back to the topic of your hearing today.

Like all other sectors, the buying and selling of services has felt the impact of the change in relative prices of information. The early innovations reflected the technological possibilities of the times. Benjamin Franklin is said to have been America's first catalog seller. Catalogs made it possible to sell things to people without buyer and seller meeting up, either via a buyer coming into a store or a seller, such as the country peddler, knocking on the buyer's door.

It's easier to adapt existing categories to explain a new innovation. The use of the Internet to bring buyers and sellers together through that medium could initially have been described as "electronic catalogs," buy anyone who has bought something via a catalog and looked at what is possible through the Internet now would find "electronic catalog" an inadequate way to describe what is possible through the Internet.

We have the same challenge in thinking about what is yet to come. Information technology is making physical location less important across many domains. Buying and selling is one of those. In our report, we offered some possibilities. Beyond those, there are possibilities whose shape is yet difficult to discern that involve the implications of "big data" and monitors and sensors. While all is in the range of speculation, an example could involve methods that learn how fast we use up household commodities and automatically order more. Running out of toilet paper would then be a thing of the past. These kinds of purchases would be made possible by

information technology, but in ways very different from the idea of someone going to a web site and following a process to make a purchase.

This notion of changes in relative prices and how information in particular has a relatively lower price is central to the issues you are grappling with today.

Differences in relative prices can be seen in the structure of the sales tax that states adopted in the 1930s. In the throes of the Depression, state governments began to introduce a general sales tax.

While the tax is a tax on those who purchase goods and services, the structure of the tax reflects the fact that the sellers have much larger scale and hence could collect and remit the sales tax much more efficiently. While I owe tax, the seller collects it and sends it to the state.

One could imagine a sales tax collected in a much different way. This alternative sales tax would be collected via returns completed by buyers. This alternative would be much more administratively burdensome than the sales tax we actually have. Buyers would be responsible for keeping receipts and periodically totaling up receipts and remitting the tax owed. The yield from the same tax rate would be much lower as individuals didn't remember all their purchases; to produce the same amount of revenue would require a higher tax rate. Enforcing the tax might involve individual audits that would be intrusive and not produce much revenue per return audited.

Comparing this version of the sales tax to the version we have, we can see how much more efficient it is to have sellers keep track of sales and remit the sales tax amount on behalf of purchasers. The society-wide burden of administering the current tax is much lower than the alternative way of administering the sales tax I've described.

For reasons relating to the history of the Supreme Court's interpretation of the Commerce Clause, the presence or absence of a state line between the location of the buyer and seller has become important for the administration of the sales tax.

States felt they could not use the same approach for collecting the sales tax when buyer and seller were in different states. Rather than favor out-of-state sellers, they adopted a use tax which follows the less-efficient "buyer collects" approach.

The weaknesses of the use tax include the higher burden on the taxpayer per unit of revenue collected and the spotty pattern of tax collection. Corporations which have tax departments staffed with skilled professionals carefully monitor tax obligation and pay taxes owed. Individuals are not much bothered to pay the tax nor do they appear to invest much effort in trying to comply.

As we noted in our report on the future of the marketplace for goods and services, in a market that is both free and fair, everybody plays by the same rules. The effect of the history of the Commerce Clause has been to create two sets of rules, one for sales where the sellers are in the same state and another where they are in different states.

The distortion that results from having two sets of rules is the difference in prices between the two sets of rules. In one, the buyer acts based on a price that includes the sales tax. In the other, the buyer may not see the sales tax.

This year, we estimate that this distortion will impact $330 billion worth of sales. In future years, that amount would likely be higher because of the continued change in relative prices. Innovation, in information technology and logistics, will expand the potential of what can be bought and sold through the Internet and other communications technologies. However, one pattern that has become clearer since we completed our report is that more sellers are losing their "out of state" status and becoming responsible for collecting the sales tax in more and more states.

As the Supreme Court framed the issue, the Commerce Clause raises the question of what is an "undue burden" on out-of-state sellers. The ongoing decline in the cost of information is reducing the cost of compliance.

The year in which the Supreme Court last considered this empirical question was 1992. At that time, the Internet was just emerging from the research community, search engines had not yet been invented, and a cell phone had the size that approached that of a loaf of bread.

Among the pieces of information whose price has declined since that time is the cost of learning what the sales tax is in any particular jurisdiction or in what jurisdiction a particular Zip Plus Four mailing address is located. "Google it," is a common phrase of our era. While a piece of information may be embedded in a complex table, our ability to get at it through search engines has made the complex seem simple.

Ensuring that the future marketplace is both free and fair requires taking into account the ongoing decline in the relative price of this information.

Mr. COBLE. You were indeed forewarned, Mr. Kuttner. You done good, as we say in the rural South. Thank you, Mr. Kuttner.

Mr. Henchman.

TESTIMONY OF JOSEPH HENCHMAN, VICE PRESIDENT, LEGAL & STATE PROJECTS, VICE PRESIDENT, OPERATIONS, TAX FOUNDATION

Mr. HENCHMAN. Thank you, Mr. Chairman, Mr. Ranking Member, Members of the Committee. Thank you for the opportunity to testify today on Congress' role in authorizing States to expand their sales tax authority to out-of-State sellers.

In the 75 years since our founding we at the Tax Foundation have monitored tax policy trends at the Federal and State levels and our analysis is guided by the principles of economically sound tax policy: Simplicity, neutrality, transparency, and stability.

To be American is to be a believer in Federalism, and that means Congress has its area and the States have their areas. Most of the time Congress should let the States do their thing, even if it is bad policy. But in a few very important situations, Congress has the power and the responsibility to get involved in State tax policy. This history is important because it is the original understanding of the Commerce Clause. The Constitution was adopted in part to give a Federal entity, the Congress, the power to rein in State tax authority when it threatens to do harm to the national economy. This is a power you have exercised in the past. Page 6 of my testimony gives some examples. In those cases you balanced, on one hand, letting the States have the ability to set tax policies in line with their interests so that citizens have choices of different baskets of goods and taxes and services with, on the other hand, ensuring that State tax power does not reach so far as to harm the free flow of commerce in the national economy. Indeed, from the founding all the way until the 1950's the rule was simple: States cannot tax interstate commerce. We are more nuanced now. Congress and the courts permit State taxation of interstate commerce where it is nondiscriminatory, fairly apportioned, related to services, and imposed on one with substantial presence in the State, nexus.

Now, as I am sure you know, and we have talked about already, States have use taxes. These taxes are imposed on items used within a State upon which sales tax has not been paid. So if I, as a D.C. resident, go up to Pennsylvania and buy a pair of blue jeans there where they are tax free and bring them back here to D.C. where I live, I owe a D.C. use tax of 6 percent and, yes, I owe it, not the seller. An economist will argue that I bear the economic burden of it, not the seller.

Now, while the purpose of use taxes is to equalize tax burdens and thwart tax competition between States, the issue you are dealing with today is about purchases made in the same State. Brick and mortar retailers rightly point out that when someone buys from them they usually pay tax, and when someone buys from an Internet retailer, they often don't pay tax. So perhaps you just let the States tax whomever they want. Well, that is the other extreme that the Supreme Court warned about in *Quill*. There are, as we have mentioned already, approximately 9,600 sales tax jurisdictions in the United States, a number that grows by several hundred each year. There is a chart on page 9 of my written testimony that shows that. States have different taxes on different items, sometimes even different times of year. Now, I have sat down and

read the sales tax statutes for the 46 States that have them, try to figure out what they tax and what they don't, a lot of the revenue rulings that try to parse out the things that aren't clear, plus there is seven States that let local government set their own sales tax basis. We at the Tax Foundation subscribe to a number of the sales tax systems and calculation software that we talk about here, and it is tough for us to keep up, and we are not also trying to run a small business, a small business that needs to know that on August 7th of this year computer microphones in the State of New Mexico are not taxed but computer headsets are, that painting canvas is exempt from tax but dry erase boards are taxed, and that the rules are completely different the next day on August 8th.

Now, if you want to do something about that disparity between Internet and brick and mortar, while making sure that States cannot foist their burdensome and complicated tax systems on out-of-State sellers the world over, there are options. I run through them on page 15 of my testimony. One of those options, the third one on my list, is the bill before you and its companions. On page 16, and if you look at anything in my testimony, it is the chart on page 16, I list features of effective simplification that should be part of any bill authorizing greater State tax power over out-of-State sellers. As you can see, this bill before you now comes a lot closer than previous efforts. However, there are some things left unchecked though. If Congress decides to modify the physical presence rule in the limited context of State taxation of use tax from out-of-State sellers, Federal standards for simplified sales tax must be an effective bulwark against aggressive State tax overreaching. Today with new technologies, even the smallest business can sell their products and services in all 50 States. The temptation is great to treat interstate commerce like a golden goose to be squeezed. When this behavior is not prevented by Congress or the courts, the results will be taxpayer uncertainty, incompatible standards, and harm to national economic growth. This temptation can only be countered by well thought out, uniform rules imposed at the Federal level.

Thank you.

[The prepared statement of Mr. Henchman follows:]

Prepared Statement of
Joseph Henchman
Vice President, Legal & State Projects
Tax Foundation

Hearing on
H.R. 3179, the Marketplace Equity Act of 2011

Before the Committee on the Judiciary,
U.S. House of Representatives

July 23, 2012

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The Proper Role of Congress in State Taxation: Ensuring the Interstate Reach of State Taxes Does Not Harm the National Economy

Joseph Henchman
Vice President, Legal & State Projects, Tax Foundation

Hearing on H.R. 3179, the Marketplace Equity Act of 2011

Before the Committee on the Judiciary,
U.S. House of Representatives

July 24, 2012

Mr. Chairman, Mr. Ranking Member, and members of the Committee:

I appreciate the opportunity to testify today on Congress's role in the debate over state sales taxation of online purchases. In the 75 years since our founding in 1937, the Tax Foundation has monitored tax policy trends at the federal and state levels, and our data and research is heavily relied upon by policymakers, the media, and the general public. Our analysis is guided by the idea that taxes should be as simple, neutral, transparent, and stable as possible, and as a 501(c)(3) non-profit, non-partisan organization, we take no position on any pending legislation.

We hope that the material we provide will be helpful in the Committee's consideration of the issue.

Executive Summary

- After the bitter experience of the Articles of Confederation, the Constitution empowered Congress with the responsibility to rein in state tax overreaching when it threatened to do harm to the national economy.
- Consequently, states were not permitted to tax items in interstate commerce at all, from the Founding until approximately the 1950s.
- Since then, as formally adopted by the U.S. Supreme Court in the *Complete Auto* decision (1977), states may tax interstate commerce so long as the tax is non-discriminatory, fairly

apportioned, related to services, and applies only to businesses with substantial presence (nexus).

- In a series of decisions, most recently the *Quill* decision of 1992, the U.S. Supreme Court explained that "substantial nexus" for sales/use tax purposes means physical presence of property or employees. The Court ruled that it exceeds to state powers for them to be able to demand use tax collection from companies that are not physically present in the state.
- States have sought to overrule the *Quill* decision, either legislatively ("Streamlined") or through defiance ("Amazon" tax statutes). The defiance approach in particular has caused significant disruption and uncertainty to the economy.
- Every state with a sales tax also imposes a use tax, levied on taxable items upon which no sales tax has been paid. In other words, use taxes seek to thwart competitive pressure from other states with lower tax rates. Taxpayer compliance with these protectionist use taxes is minimal. (Use tax, with a few exceptions, is imposed on the *consumer* and not the *seller*.)
- Congress has passed a number of statutes limiting the scope of state tax authority on interstate activities ("preemption"), carefully balancing (1) the ability of states to set tax policies in line with their interests and that allow interstate competition for citizens over baskets of taxes and services and (2) limiting state tax power to export tax burdens to non-residents or out-of-state companies, or policies that would excessively harm the free-flow of commerce in the national economy.
- When a resident of a state purchases from a brick-and-mortar retailer, they generally must pay sales tax. When the same resident in the same state purchases the same product from an online retailer, they often do not pay sales tax.
- Many large Internet retailers are expanding the number of states in which they have physical presence, to enable next-day delivery, but that is not the case for many smaller sellers that remain in just one location and use common carriers to deliver purchases.
- There are approximately 9,600 jurisdictions in the United States that collect sales tax, a number that grows by several hundred each year. Subscription tax software is inadequate and can be expensive for occasional sellers, and few states provide adequate tax lookup or consolidated tax filing options. Sales tax can vary by product, by time, and by location in the state. In 7 states, local governments can have a different sales tax base from the state tax base.

- Congress has five basic options on how it may proceed:
    - *Reaffirm the physical presence rule* for sales taxation, and by implication, the disparity of treatment between brick-and-mortar sales and Internet sales.
    - *Reaffirm the physical presence rule* but adopt a new tax approach that mitigates the disparity of treatment between brick-and-mortar sales and Internet sales (such as an origin-based system or a national sales tax on online purchases).
    - *Modify the physical presence rule* in the limited context of state collection of use tax from out-of-state sellers, by those states that have adopted simplified sales tax systems under minimal federal standards, to reduce the harm to interstate commerce. This trade-off would replace the check on state power provided at present by the physical presence rule.
    - *Repeal the physical presence rule* without conditions on the states, granting states unchecked authority to export tax burdens and damage interstate commerce.
    - *Do nothing* and risk the continued growth of unchecked and fragmented state authority to export tax burdens and damage interstate commerce.

The Constitution Empowers Congress to Limit State Tax Power When It Seeks to Shift Tax Burdens to Non-Residents or Do Harm the National Economy

What you have before you is not a new issue. Absent congressional or judicial checks, states have an incentive to shift tax burdens from physically present individuals and businesses, to those who are beyond their borders. Indeed, it was the states' unchecked behavior in this regard that led to the Constitutional Convention in the first place. Under the Articles of Confederation, states with ports taxed commerce bound for interior states, tariff wars proliferated, and the national economy was imperiled. As Justice Johnson described in 1824, these actions were "destructive to the harmony of the states, and fatal to their commercial interests abroad. This was the immediate cause that led to the forming of a convention."[1]

And so the Constitution was adopted, and through that document, the Congress was granted the power to restrain states from enacting laws that harm the national economy by discriminating

[1] *See, e.g.*, *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1, 224 (1824) (Johnson, J., concurring).

against interstate commerce.[2] James Madison noted that these powers would check the "clamors of impatient avidity for immediate and immoderate gain" that drive state legislation discriminating against non-residents.[3] Justice Story later praised the "wisdom and policy in restraining the states themselves from the exercise of [taxation] injuriously to the interests of each other. A petty warfare of regulation is thus prevented, which would rouse resentments, and create dissensions, to the ruin of the harmony and amity of the states."[4]

So strong was this concern that the rule for a century and a half was that states could not tax interstate commerce at all.[5] This eroded in the 1950s and 1960s as it was recognized that those engaged in interstate commerce do enjoy benefits in states where they are present, so it is not unfair to have them support those services with taxes. The complete ban on state taxation of interstate commerce was abandoned in 1977, replaced by a recognition that resident businesses engaged in interstate commerce should pay for the fair share of the state services they consume. In *Complete Auto Transit, Inc. v. Brady*, the U.S. Supreme Court held that states may tax interstate commerce if the tax meets a four part test:[6]

- **nexus**, *a sufficient connection between the state and the taxpayer;*
- **fair apportionment**, *the state cannot tax beyond its fair share of the taxpayer's income;*
- **nondiscrimination**, *the state must not burden out-of-state taxpayers while exempting in-state taxpayers;*
- **fairly related**, *the tax must be fairly related to services provided to the taxpayer.*

Before and since *Complete Auto*, the courts have routinely exercised this power to restrain state tax infringements on interstate commerce, and these decisions are one of the more non-controversial aspects of constitutional law.[7] Congress has also been active in this area, legislating limits on state tax

[2] *See* U.S. CONST. art. I, § 8, cl. 3 (Interstate Commerce Clause); U.S. CONST. art. I, § 10, cl. 2 (Import-Export Clause); U.S. CONST. art. I, § 10, cl. 3 (Tonnage Clause); U.S. CONST. art. IV, § 2, cl. 1 (Privileges and Immunities Clause); U.S. CONST., amend. XIV, § 1 (Privileges or Immunities Clause).
[3] James Madison, THE FEDERALIST NO. 42 (1788).
[4] 1 STORY CONST § 497.
[5] *See, e.g.*, *Freeman v. Hewit*, 329 U.S. 249, 252-53 (1946) ("A State is ... precluded from taking any action which may fairly be deemed to have the effect of impeding the free flow of trade between States"); *Leloup v. Port of Mobile*, 127 U.S. 640, 648 (1888) ("No State has the right to lay a tax on interstate commerce in any form.").
[6] 430 U.S. 274 (1977).
[7] The power of the federal courts to act when Congress is silent is inferred as an implication of the Commerce Clause, a doctrine often referred to as the "dormant" or "negative" Commerce Clause. *See, e.g.*, *Willson v. The Black Bird Creek Marsh Co.*, 27 U.S. 245 (1829). The Commerce Clause prohibits states from imposing a tax on activity out-of-state while leaving identical activity in-state untaxed. *See Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318 (1977)

power where states are incapable of achieving a simplified, uniform system that restrain each state from claiming more than its fair share of taxes on interstate commerce. These have included prohibiting state taxes on food stamps, Federal Reserve banks, interstate airline and bus travel, satellite services, and nonresident members of the military and nonresident members of Congress. Congress has also banned discriminatory state taxes on federal employees, interstate electricity transmission, and interstate railroads (see Table 1).

This power—to limit state tax authority—is not a power to use lightly. There are many components of state tax systems that, frankly, are none of Congress's business, even if they are good or bad public policy. Those aspects of state tax systems that are neither motivated by protectionism nor have the effect of raiding revenue from out-of-staters should be left alone as part of our commitment to fifty

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(invalidating a New York tax imposed solely on activity out-of-state while leaving identical activity in-state untaxed); *Westinghouse Elec. Co. v. Tully*, 466 U.S. 388 (1984) (invalidating a New York scheme exempting activity in-state while simultaneously imposed a tax on identical activity out-of-state); *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984) (invalidating a Hawaii tax imposed on a category of products but exempting activity in-state); *Am. Trucking Ass'n v. Scheiner*, 483 U.S. 266 (1987) (invalidating a Pennsylvania scheme imposing fees on all trucks while reducing other taxes for trucks in-state only); *New Energy Co. v. Limbach*, 486 U.S. 269 (1988) (invalidating an Ohio tax credit to all ethanol producers but disallowed for non-Ohio producers); *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994) (invalidating a Massachusetts general tax on dairy producers where the revenue was then distributed to domestic dairy producers); *Camps/Newfound/Owatanna, Inc. v. Town of Harrison*, 520 U.S. 564 (1997) (invalidating Maine's denial of the general charitable deduction to organizations that primarily serve non-Maine residents). *But see Dep't. of Revenue of Ky. v. Davis*, 553 U.S. 328 (2008) (upholding Kentucky's exclusion from tax of interest earned from its state bonds, but not other states bonds, on the grounds that Kentucky is acting as a market participant no different from any other bond issuer).

The Import-Export Clause prohibits states from penalizing activity that crosses state lines, particularly imports. *See, e.g.*, *Michelin Corp. v. Wages*, 423 U.S. 276, 295 (1976) (stating that the Import-Export Clause prohibits import taxes that "create special protective tariffs or particular preferences for certain domestic goods. . . ."). Justice Clarence Thomas, a critic of dormant commerce clause jurisprudence, nonetheless argues that taxes that discriminate against nonresidents should be invalidated by the courts under the Import-Export Clause. *See Camps/Newfound/Owatanna*, 520 U.S. at 610 (Thomas, J., dissenting) ("That the expansion effected by today's decision finds some support in the morass of our negative Commerce Clause case law only serves to highlight the need to abandon that failed jurisprudence and to consider restoring the original Import-Export Clause check on discriminatory state taxation to what appears to be its proper role.").

The Tonnage Clause prohibits charges on shipping freight.

The Privileges and Immunities Clause of Article IV and the Privileges or Immunities Clause of the Fourteenth Amendment protects the right of citizens to cross state lines in pursuit of an honest living. *See, e.g.*, *United Bldg. & Constr. Trades v. Mayor*, 465 U.S. 208, 219 (1984) (identifying "pursuit of a common calling" as a privilege of citizenship protected by the Constitution); *Saenz v. Roe*, 526 U.S. 489 (1999) (invalidating a law that did not restrict state travel *per se* but discouraged the crossing of state lines with a punitive and discriminatory law); *id.* at 511 (Rehnquist, J., dissenting) ("The right to travel clearly embraces the right to go from one place to another, and prohibits States from impeding the free passage of citizens); Erwin Chemerinsky, CONSTITUTIONAL LAW 450 (2d ed. 2002) ("The vast majority of cases under the [Article IV] privileges and immunities clause involve states discriminating against out-of-staters with regard to their ability to earn a livelihood.").

simultaneous laboratories for policy experiments, to paraphrase Justice Brandeis.[8] If bad state policy can be corrected by the political pressure of voting resident taxpayers or by the economic pressure of the out-migration of people and dollars, it ought to be left to the states to handle.

Table 1: Examples of Congressional Preemption of State Tax Authority

4 U.S.C. § 111	Preempting discriminatory state taxation of federal employees
4 U.S.C. § 113	Preempting state taxation of nonresident members of Congress
4 U.S.C. § 114	Preempting discriminatory state taxation of nonresident pensions
7 U.S.C. § 2013	Preempting state taxation of food stamps
12 U.S.C. § 531	Preempting state taxation of Federal Reserve banks, other than real estate taxes
15 U.S.C. § 381 *et seq.*	Preempting state and local income taxes on a business if the business's in-state activity is limited to soliciting sales of tangible personal property, with orders accepted outside the state and goods shipped into the state. (Often referred to as Public L. 86-272.)
15 U.S.C. § 391	Preempting discriminatory state taxes on electricity generation or transmission
31 U.S.C. § 3124	Preempting state taxation of federal debt obligations
43 U.S.C. § 1333 (2)(A)	Preempting state taxation of the outer continental shelf
45 U.S.C. § 101	Preempting state income taxation of nonresident water carrier employees
45 U.S.C. § 501	Preempting state income taxation of nonresident employees of interstate railroads and motor carriers, and Amtrak ticket sales
45 U.S.C. § 801 *et seq.*	Preempting discriminatory state taxation of interstate railroads
47 U.S.C. § 151	Preempting state taxation of Internet access, aside from grandfathered taxes
47 U.S.C. § 152	Preempting local but not state taxation of satellite telecommunications services
49 U.S.C. § 101	Preempting state taxation of interstate bus and motor carrier transportation tickets
49 U.S.C. § 1513 *et seq.*	Preempting state taxation of interstate air carriers and air transportation tickets
49 U.S.C. § 40101	Preempting state income taxation of nonresident airline employees
49 U.S.C. § 40116(b)	Preempting state taxation of air passengers
49 U.S.C. § 40116(c)	Preempting state taxation of flights unless they take off or land in the state
50 U.S.C. § 574	Preempting state taxation of nonresident members of the military stationed temporarily in the state

Source: Tax Foundation compilation.

However, there are situations where it is vital that Congress use this power, where the alternative is the problem we experienced as a young country under the Articles of Confederation. While everyone is for simple taxes and fair taxes, in practice states look for any advantage or opportunity to shift tax burdens from voting residents to non-voting non-residents, to benefit in-state businesses and

[8] *See New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting) ("It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.").

individuals by adopting tax policies that discriminate against out-of-state businesses and individuals. For all the discussion about how nonresident companies benefit from state services, the real issue usually is shifting tax burdens away from voting residents to someone else. As Professor Daniel Shaviro has put it, "Perceived tax exportation is a valuable political tool for state legislators, permitting them to claim that they provide government services for free."[9] Without court intervention or congressional action (or the threat of congressional action), efforts to get states to solve interstate tax issues have historically failed, because as soon as a state thinks they can ger a bigger share of the pie by breaking the agreement, they do so, and the whole thing unravels.

As one example, the threat of congressional action by the Willis Commission in 1959 led to the adoption of uniform state corporate income tax apportionment rules. This standardization, however, only lasted twenty years before Iowa deviated from it to gain an advantage for itself. Many other states have followed, and today, only 11 states still adhere to the uniform rule. The trend continues to move away from uniformity, not towards it, despite the existence of voluntary organizations like the Multistate Tax Commission (MTC) and the Federation of Tax Administrators (FTA) that exist to advance uniformity in such rules.

Nexus Based on Physical Presence

We at the Tax Foundation have monitored the increasing use of tax policy by states to do precisely what I have described: shift tax burdens from out-of-state businesses and individuals to benefit in-state businesses and individuals, through discriminatory tax policy. These generally involve disputes over "nexus" standards: the proper scope of state tax power over non-resident individuals and businesses.

Generally, the historical standard is that states may tax those physically present in the jurisdiction, and may not tax those not physically present. This is premised on a view known as the "benefit principle": that the taxes you pay should roughly approximate the services you consume. State spending overwhelmingly, if not completely, is meant to benefit the people who live and work in the jurisdiction. Education, health care, roads, police protection, broadband access, etc.: the primary beneficiaries are state residents. The "benefit principle" thus means that residents should be paying taxes where they work and live, and jurisdictions should not tax those who don't work and live there.

[9] Daniel Shaviro, "An Economic and Political Look at Federalism in Taxation," 90 Mich. L. Rev. 895, 957 (1992).

A physical presence standard for state taxation is in line with this fundamental view of taxation.

Developments have arisen in the three major state tax areas (corporate income tax, individual income tax and sales tax), as well as with some other state taxes (such as telecommunications taxes, taxes on digital goods, car rental taxes, and so forth). Bills have been introduced in the Congress that seek to reaffirm the physical presence rule in these areas (such as BATSA with corporate income tax, Mobile Workforce with individual income tax).

Recent Developments in State Sales Tax: Overview

There are a number of proposals to reverse a series of U.S. Supreme Court decisions (most recently the *Quill* decision of 1992) that prohibit states from imposing sales tax collection obligations on businesses with no property or employee in the state. This "physical presence" standard is meant to prevent states from shifting tax burdens to non-residents away from residents who are the primary beneficiary of state services, while also protecting the free flow of interstate commerce from the compliance costs of non-uniform and numerous (9,600+) sales tax jurisdictions in the United States (see Figure 1, Figure 2, Table 2, and Table 3).

The steadily increasing growth of Internet-based commerce has however led to frustration with this standard, primarily due to disparate sales tax treatment of similar goods within states that has no economic basis. This can be addressed while also ensuring that some standard exists to restrain states from engaging in destructive behavior, such as tax exporting to non-voters or imposing heavy compliance costs on interstate businesses, that the Congress is empowered to prevent. Further, because economic integrarion is greater now than it has ever been before, the economic costs of nexus uncertainty are also greater today and can ripple through the economy much more quickly.

These actions are only the latest chapter in a long saga over the proper tax treatment of sales made over the Internet, and an even longer saga over the proper scope of state taxing authority. At its core is a dispute over which is more important: limiting state power to tax nonresidents and thus harm the national economy, or ensuring that some transactions do not escape tax because they are conducted online. Discussions following a recent compromise in California, driven by the desire of large Internet retailers to expand their physical presence to enable next-day delivery, suggest that there are policy options that could achieve both ends.

Figure 1: New State/Local Sales Tax Jurisdictions Created Each Year

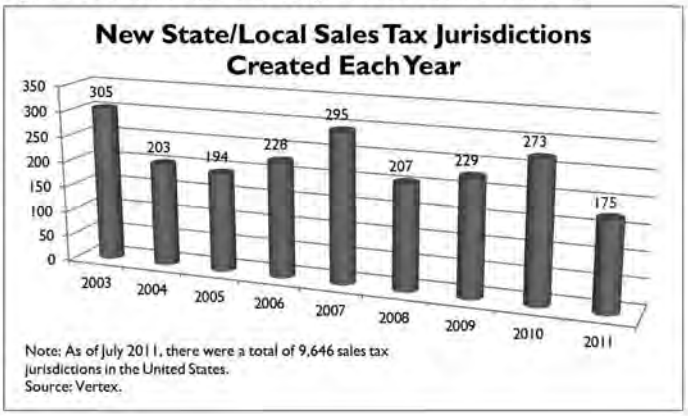

Figure 2: Sales Tax Jurisdictions with Changes Each Year

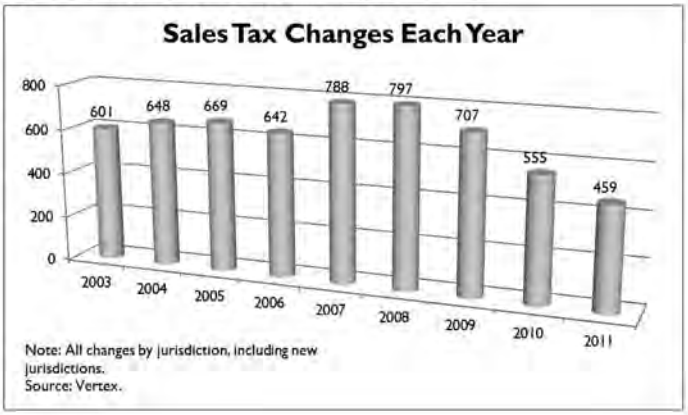

Table 2: Example of Sales Tax Complexity: Taxation of a Bottled Frappuccino® Beverage Under Current and Proposed State Legislation

State	Tax on Bottled Frappuccino®?
Enacted	
Arkansas	No
Tennessee	Yes
Virginia	No
West Virginia	Yes
Proposed	
Arizona	No
California	No
Connecticut	Unclear
Hawaii	Yes
Illinois	Yes
Mississippi	Yes
Montana	Yes
New Mexico	Yes
Oregon	No
Rhode Island	No
Tennessee	Yes
Texas	Yes
Utah	Yes
Vermont	Yes

Source: Scott Drenkard, *Overreaching on Obesity: Governments Consider New Taxes on Soda and Candy*, Tax Foundation Special Report No. 196 (Oct. 2011)

Table 3: Other Examples of Contributors to Sales Tax Complexity

States With Local Option Sales Taxes: 37
States That Permit Local Government to Define A Separate Sales Tax Base: 7
States With Sales Tax Holidays: 17

The *Quill* Decision: Not a Loophole, But a Check on State Power to Export Tax Burdens and Do Harm Interstate Commerce

What is nexus for a remote seller? In 1967, the U.S. Supreme Court held that a business does not have nexus with a state if the business has no retail outlets, solicitors, or property in the state, and communicates with customers only by mail or common carrier as part of a general interstate business.[10] Otherwise, the Court concluded, states could "entangle National's interstate business in a virtual welter of complicated obligations to local jurisdictions with no legitimate claim to impose a fair share of the cost of the local government." This decision was reaffirmed after the *Complete Auto* test was announced in 1977.[11]

During the 1980s, some academics and many states criticized *National Bellas Hess* as archaic, formalistic, and outmoded. Officials were encouraged to ignore the decision, and some state courts disregarded it, even as the number of sales taxes rose from 2,300 to 6,000. Different murky definitions of economic nexus have been proposed:

- Engaged in exploiting the local market on a regular, systematic, large-scale basis.
- Presence of intangible property or affiliates
- Number of customers in state, value of assets or deposits in the state, and receipts attributable to sources in the state
- Analysis of frequency, quantity, and systematic nature of taxpayer's economic contacts with the state
- Derivation of economic benefits from state's residents

Defying the Court rulings, North Dakota enacted a law requiring the out-of-state Quill Corp. to collect sales tax on its sales to 3,000 in-state customers. Any state that advertised three times in the state was liable. In the case, the U.S. Supreme Court reaffirmed *National Bellas Hess* and *Complete Auto*.[12] There they stated that the physical presence rule "firmly establishes the boundaries of legitimate state authority to impose a duty to collect sales and use taxes and reduces litigation concerning those taxes." Justice Byron White dissented, arguing two points that continue to be made today: (1) injustice that some sales escape taxation and (2) arguing that technological change had made discriminatory compliance costs no longer burdensome.

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[10] *See National Bellas Hess, Inc. v. Dept. of Revenue of Ill.*, 386 U.S. 753, 759-60 (1967).
[11] *See Nat'l Geographic Society v. Ca. Bd. Of Equalization*, 430 U.S. 551, 559 (1977).
[12] *See Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

The Streamlined Sales Tax Project Has Watered Down Membership Standards in an Unsuccessful Effort to Entice More State Members in Its Effort to Change *Quill*

Today, there are over 9,600 state and local sales tax jurisdictions in the United States. There are different rates on different items, they change frequently, and are not even aligned to 9-digit zip codes. States are reluctant to cooperate on even basic rules and definitions.

The Streamlined Sales Tax Project (SSTP) was launched in 2000 with the mission of getting states to adopt changes to their sales taxes to make them simple and uniform. SSTP then hopes to convince Congress or the courts to overrule *Quill* and allow use tax collection obligations on out-of-state companies ("Main Street Fairness Act").

However, the SSTP has abandoned simplification efforts and any attempt to reduce the number of sales tax jurisdictions, instead focusing on uniformity efforts. In many cases, the Project has enabled state sales tax complexity by permitting separate tax rates for certain goods. States generally are reluctant to yield parochial advantages, even with the possibility of online sales tax revenue in return, undermining their argument to Congress as part of the Main Street Fairness Act that they have succeeded in their mission. Large states have generally avoided the SSTP, and membership has been stuck at ~20 states for some time. This in turn has led to impatience from states and others.

Some States Have Sought to Defy *Quill* through Unconstitutional Legislation

In 2008, New York adopted an "Amazon" tax, nicknamed after the Internet retailer as the most visible target. The law held that a person or business with no physical presence in the state nevertheless has nexus if it (1) enters into agreement with in-state resident involving commissions for referring potential customers; and (2) has gross receipts from sales by out-of-state company from referrals within the state are more than $10,000 in a 12-month period.

Amazon.com & Overstock.com responded by terminating affiliate programs in New York, and Amazon.com filed a lawsuit in state court. The law was upheld by a trial judge (New York's trial courts are called the "New York Supreme Court," causing confusion about who upheld the Amazon tax as constitutional); the judge concluded that Amazon.com's in-state affiliates are necessary and significant to establishing and maintaining out-of-state company's market in the state. But because they make up only 1.5% of sales, that was the basis for the appeal. The New York Supreme Court, Appellate Division ruled in late 2010 that law is not facially unconstitutional but may be

unconstitutional for Amazon. The case was remanded to the lower court, but Amazon is appealing to state's highest court, the New York Court of Appeals. The case is ongoing.

In 2009, Rhode Island and North Carolina adopted identical New York-style laws. Neither has seen any revenue and Rhode Island has actually seen revenue loss due to reduced income tax collections from terminated in-state affiliates. Laws were also passed in California and Hawaii but vetoed. (See Table 4 for a status of all state efforts to defy *Quill* legislatively.)

Table 4: Status of State Efforts to Defy *Quill* Legislatively

Arkansas	Enacted mid-2011.
California	Enacted mid-2011 but effective date postponed after agreement reached with state.
Colorado	Enacted 2010. Ruled unconstitutional.
Connecticut	Enacted mid-2011.
Illinois	Enacted 2011. Ruled unconstitutional.
New York	Enacted 2008. In litigation.
North Carolina	Enacted 2009. Ruled unconstitutional.
Rhode Island	Enacted 2009. Officials report that the law has reduced state tax collections. May be repealed.

Source: Tax Foundation compilation. Does not include states where legislation was proposed but not adopted.

In 2010, Colorado considered the same law but faced opposition from in-state affiliates. Instead it adopted a law (H.B. 10-1193) designed to push Amazon into collecting use taxes without explicitly requiring it. Any out-of-state retailer that is part of "a controlled group of corporations" with at least one member with physical presence in Colorado, all the retailers in the group have nexus with Colorado. However, the "only" obligation with this nexus is notification:

- "[N]otify Colorado purchasers that sales or use tax is due on certain purchases made from the retailer and that the State of Colorado requires the purchaser to file a sales or use tax return." Penalty of $5 per failure per customer, plus criminal penalties.
- "[Notify] all Colorado purchasers by January 31 of each year showing such information as the Colorado Department of Revenue shall require by rule and the total amount paid by the purchaser for Colorado purchases made from the retailer in the previous calendar year. Such notification shall include, if available, the dates of purchases, the amounts of each purchase, and the category of the purchase, including, if known by the retailer, whether the purchase is exempt or not exempt from taxation." Must be sent separately from shipments and be by first-class mail. CC to State. Penalty of $10 per failure per customer, plus criminal penalties.

Amazon.com terminated affiliate programs in Colorado. In January 2010, a federal judge stayed the law stayed as probably unconstitutional on First Amendment grounds, and the law was thrown out completely in April 2012.[13]

North Carolina followed Colorado by adopting regulation with similar/notification requirements. They demanded out-of-state companies provide them with all customer purchase information dating from 2003, by April 19, 2010. Amazon.com and the ACLU filed lawsuit in federal court, arguing that "[e]ach order of a book, movie, CD or other expressive work potentially reveals an intimate fact abour an Amazon customer" (see Table 5).

Table 5: Examples of Purchases Required to Be Disclosed to State Officials under the North Carolina Law

Bipolar Disorder: A Guide for Parents and Families
He Had It Coming: How to Outsmart Your Husband and Win Your Divorce
Living with Alcoholism: Your Guide to Dealing with Alcohol Abuse and Addiction While Getting the Alcoholism Treatment You Need
What to Do When You Can't Get Pregnant: The Complete Guide to All the Technologies for Couples Facing Fertility Problems
Outing Yourself: How to Come out as Lesbian or Gay to Your Family, Friends, and Coworkers
Lolita (1962)
Brokeback Mountain (2005)
Fahrenheit 9/11 (2004)

Source: ACLU brief in the North Carolina case.

A federal judge struck down the North Carolina regulation as violating First Amendment in October 2010. In 2011, Illinois and Arkansas enacted New York-style laws (the Illinois law was subsequently ruled unconstitutional). California enacted one but after a possible repeal referendum was proposed, the state and Amazon.com reached an agreemenr whereby Amazon.com will develop a physical presence in the state (*i.e.*, build warehouses).

While for the most part unsuccessful, these state efforts have highlighted the desire to modify the *Quill* holding in some way. This pressure is likely to continue.

[13] *See* Mark Robyn, "Colorado Amazon Regulations Ruled Unconstitutional," (Apr. 4, 2012), http://www.taxfoundation.org/blog/show/28111.html

Possible Solutions

Substantial progress has been made in recent months toward possible solutions that could (1) simplify sales tax systems and avoid discriminatory compliance costs, (2) eliminate non-neutral tax rates on similar products sold by online and brick-and-mortar businesses, (3) limit taxation in a state to those residents who enjoy the benefits of state services, (4) prevent multiple taxation of interstate commerce, and (5) prevent unconstitutional and fragmented state attempts to impose such tax burdens in a destructive manner.

Congress has five basic options on how it may proceed:

- *Reaffirm the physical presence rule* for sales taxation, and by implication, the disparity of treatment between brick-and-mortar sales and Internet sales.
- *Reaffirm the physical presence rule* but adopt a new tax approach that mitigates the disparity of treatment between brick-and-mortar sales and Internet sales (such as an origin-based system or a national sales tax on online purchases).
- *Modify the physical presence rule* in the limited context of state collection of use tax from out-of-state sellers, by those states that have adopted simplified sales tax systems under minimal federal standards, to reduce the harm to interstate commerce. This trade-off would replace the check on state power provided at present by the physical presence rule.
- *Repeal the physical presence rule* without conditions on the states, granting states unchecked authority to export tax burdens and damage interstate commerce.
- *Do nothing* and risk the continued growth of unchecked and fragmented state authority to export tax burdens and damage interstate commerce.

I'll focus the remainder of my analysis on the third option, which would allow the states to collect use tax from remote sellers on condition that they simplify their sales tax systems in accordance with minimum federal specifications. If the Committee is interested in further discussion of the other alternatives, we will be happy to do so.

The Marketplace Equity Act (H.R. 3179) and Marketplace Fairness Act (S. 1832) are two recent proposals that would eliminate the physical presence rule but otherwise make advances towards ensuring that states reduce the burdens associated with collecting their sales taxes. Example provisions include requirements that states have a single state-level agency that administer all sales

tax rules, offer one tax return and audit for the entire state, require one uniform tax base for the entire state, provide software that identifies the applicable tax rate for a sale, including local rates and hold sellers harmless for any software errors or mistakes by the state, provide 30 days' notice of any local sales tax rate change, and exempt sellers with a *de minimis* level of collections. (See Table 6 for a comparison.)

Effective simplification is a necessity for any federal proposal.

Table 6: Provisions of Current Pending Federal Legislation

Before Collecting Remote Use Tax, State Must…	**Marketplace Equity Act**	**Marketplace Fairness Act**	**Main Street Fairness Act**
Designate one state entity to collect, process, and audit returns for all tax jurisdictions in the state.	✓	✓	✓
Establish unified audit of remote sellers for all taxing jurisdictions in the state.	✗	✓	✗
Establish a single tax return for all taxing jurisdictions in the state.	✓	✓	✓
Provide or certify tax collection and remittance software. (**Note**: Not necessarily free software)	✓	✓	✓
Hold remote sellers harmless for errors in state-provided software.	✓	✓	✓
Adopt standardized definitions of commonly taxed goods.	✗	✗	✓
Offer immunity to remote sellers who misapply sales tax holidays.	✗	✗	✗
Compensate vendors.	✗	✗	✓
Offer a single statewide blended rate as an option.	✓	✗	✗
Require local jurisdictions to use the state's sales tax base.	✓	✓	✓
Require local jurisdictions to align geographically with 5-digit zip codes	✗	✗	✗
Legislation explicitly preempts other state efforts to force use tax collection by tax out-of-state sellers.	✗	✗	✗
"Small seller exception"	$1m in U.S., $100k in state	$500k in U.S.	To be set
Legislation establishes federal court jurisdiction for enforcing simplification standards.	✗	✗	✓

Source: Tax Foundation review of legislation. Main Street Fairness Act review includes only provisions incorporated in federal law, not those merely adopted by its Governing Board.

All these simplifications are desirable, and together would provide a sufficient check on state tax overreaching while leaving ample space for states to structure their tax systems and rates in line with their own preferences. The only infringement on state sovereignty is an infringement on state power to burden interstate commerce with problematic tax policy.

Congress has passed a number of statutes limiting the scope of state tax authority on interstate activities, carefully balancing (1) the ability of states to set tax policies in line with their interests and that allow interstate competition for citizens over baskets of taxes and services and (2) limiting state tax power to export tax burdens to non-residents or out-of-state companies, or policies that would excessively harm the free-flow of commerce in the national economy. A package specifying a floor of all the simplifications listed in Table 6 would be welcome and would greatly reduce constraints on economic growth.

Sales Tax: Combined State and Average Local Rates

Tax Year 2012

www.TaxFoundation.org

Note: Some states levy gross receipts taxes in addition to sales taxes. See Table 20 for information on gross receipts taxes.
(a) City, county and municipal rates vary. These rates are weighted by population to compute an average local tax rate. (b) Three states collect a separate, uniform "local" add-on sales tax: California (1%), Utah (1.25%), Virginia (1%). We include these in their state sales tax. (c) The sales taxes in Hawaii, New Mexico and South Dakota have broad bases that include many services, so their rates are not strictly comparable to other states. (d) Due to data limitations, table does not include sales taxes in local resort areas in Montana. (e) Some counties in New Jersey are not subject to the statewide sales tax rate and collect a local rate of 3.5%. Their average local score is represented as a negative.
Source: Tax Foundation; Sales Tax Clearinghouse.

State and Local Sales Tax Rates
As of January 1, 2012

State	State Tax Rate	Rank	Avg. Local Tax Rate (a)	Combined Rate	Rank
Ala.	4.00%	38	4.33%	8.33%	8
Alaska	None	46	1.77%	1.77%	46
Ariz.	6.60%	9	2.52%	9.12%	2
Ark.	6.00%	16	2.58%	8.58%	6
Calif. (b)	7.25%	1	0.86%	8.11%	12
Colo.	2.90%	45	4.54%	7.44%	15
Conn.	6.35%	11	None	6.35%	31
Del.	None	46	None	0.00%	47
Fla.	6.00%	16	0.62%	6.62%	29
Ga.	4.00%	38	2.84%	6.84%	24
Hawaii (c)	4.00%	38	0.35%	4.35%	45
Idaho	6.00%	16	0.02%	6.02%	35
Ill.	6.25%	13	1.95%	8.20%	10
Ind.	7.00%	2	None	7.00%	20
Iowa	6.00%	16	0.81%	6.81%	25
Kans.	6.30%	12	1.96%	8.26%	9
Ky.	6.00%	16	None	6.00%	36
La.	4.00%	38	4.85%	8.85%	3
Maine	5.00%	31	None	5.00%	43
Md.	6.00%	16	None	6.00%	36
Mass.	6.25%	13	None	6.25%	33
Mich.	6.00%	16	None	6.00%	36
Minn.	6.875%	7	0.30%	7.18%	17
Miss.	7.00%	2	0.004%	7.00%	19
Mo.	4.225%	37	3.26%	7.49%	14
Mont. (d)	None	46	None	0.00%	47
Nebr.	5.50%	28	1.27%	6.77%	26
Nev.	6.85%	8	1.08%	7.93%	13
N.H.	None	46	None	0.00%	47
N.J. (e)	7.00%	2	-0.03%	6.97%	22
N.M. (c)	5.125%	30	2.12%	7.24%	16
N.Y.	4.00%	38	4.48%	8.48%	7
N.C.	4.75%	35	2.10%	6.85%	23
N.D.	5.00%	31	1.39%	6.39%	30
Ohio	5.50%	28	1.25%	6.75%	27
Okla.	4.50%	36	4.16%	8.66%	5
Ore.	None	46	None	0.00%	47
Pa.	6.00%	16	0.34%	6.34%	32
R.I.	7.00%	2	None	7.00%	20
S.C.	6.00%	16	1.13%	7.13%	18
S.D.	4.00%	38	1.39%	5.39%	41
Tenn.	7.00%	2	2.45%	9.45%	1
Tex.	6.25%	13	1.89%	8.14%	11
Utah (b)	5.95%	27	0.73%	6.68%	28
Vt.	6.00%	16	0.14%	6.14%	34
Va. (b)	5.00%	31	None	5.00%	43
Wash.	6.50%	10	2.30%	8.80%	4
W.Va.	6.00%	16	None	6.00%	36
Wis.	5.00%	31	0.43%	5.43%	40
Wyo.	4.00%	38	1.34%	5.34%	42
D.C.	6.00%	(16)	-	6.00%	(36)

Conclusion

Businesses throughout our nation's history have plied their trade across state lines. Today, with new technologies, even the smallest businesses can sell their products and services in all fifty states through the Internet and through the mail. Business travel is easier than ever before. If such sales, travel, or activity can now expose these businesses to tax compliance and liability risks in states where they merely have customers, they will be less likely to expand their reach into those states. Interstate commerce is not a golden goose that can be squeezed without adverse effects on economic growth. Unless a single uniform nexus standard is established, the conflicting standards will impede the desire and the ability of businesses to expand, which harms the nation's economic growth potential.

We at the Tax Foundation track the numerous rates, bases, exemptions, credits, adjustments, phaseouts, exclusions, and deductions that litter our federal and state tax codes. Frequent and ambiguous alterations of tax codes and the confusion they cause are a key source of the growing tax compliance burden. We have several staffers as well as computer-based and publication subscriptions dedicated to being up to date and accurate on the frequent changes to the many taxes in our country, but even we have trouble doing it. It would be extremely difficult for individuals and businesses who are in business to sell a good or service, not to conduct tax policy research.

Congress can obtain evidence from interested stakeholders and take political and economic factors into consideration when developing new rules of taxation. The Supreme Court, by contrast, must develop broad doctrine in a case-by-case fashion, based on the facts of the particular case before them. (Additionally, the Court seems to have an aversion to tax cases in general and these type of tax cases in particular.) This is why congressional action, which can be more comprehensive and accountable than judicial action, and can better address issues of transition, retroactivity, and *de minimis* exemptions, may now be the best vehicle for preventing burdens to interstate commerce. It is up to Congress to exercise its power to protect interstate commerce.

We now live in a world of iPods, telecommuting, and Amazon.com. It is a testament to the Framers that their warnings about states' incentives to hinder the national economy remain true today.

Some may argue that faster roads and powerful computers mean that states should now be able to tax everything everywhere. While some constitutional principles surely must be revisited to be applied to new circumstances, the idea that parochial state interests should not be permitted to

burden interstate commerce remains a timeless principle regardless of how sophisticated technology may become.

ABOUT THE TAX FOUNDATION

The Tax Foundation is a non-partisan, non-profit research institution founded in 1937 to educate taxpayers on tax policy. Based in Washington, D.C., our economic and policy analysis is guided by the principles of sound tax policy: simplicity, neutrality, transparency, and stability.

ABOUT THE CENTER FOR LEGAL REFORM AT THE TAX FOUNDATION

The Tax Foundation's Center for Legal Reform educates the legal community and the general public about economics and principled tax policy. Our research efforts focus on the scope of taxing authority, the definition of tax, economic incidence, and taxpayer protections.

Mr. COBLE. Thank you, Mr. Henchman.
Mr. DelBianco.

TESTIMONY OF STEVE DelBIANCO, EXECUTIVE DIRECTOR, NetCHOICE

Mr. DELBIANCO. Thank you, Mr. Chairman, Ranking Member Conyers, Members of the Committee. I also speak today for members of a new coalition, the True Simplification of Taxation, which

includes the American Catalog Mailers, the Direct Marketing, and the Electronic Retailing associations. It must be incredibly hard to get a handle on this issue when you hear such contradictory facts and counter arguments. I personally have really enjoyed debating this on some of the TV talk shows, but I have to admit it is not very enlightening to anybody who watches it. You deserve some straight answers today.

So, first, is this legislation really about equity and fairness? Equity is when everyone plays by the same rules, and that is the situation today. Every online and catalog retailer, just like every store, collects sales tax for every place they have a physical presence, but this bill requires remote businesses to pay sales tax based on where the customer lives. Now, if you really wanted equity, let's force all stores to do sales tax that same way. So think about the outlet malls on I-95 or the souvenir shops in downtown Washington where nearly all the customers come from out of State. Equity would mean, what, requiring their customers to show an ID so the clerk could figure out the sales tax where they live and file a return where they live? No, that is ridiculous. You wouldn't do that. But that is the unfair burden this legislation would impose on online and catalog sellers in other States.

We talked a lot about *Quill*, and in *Quill* the Court said it was concerned not so much by fairness as by, quote, concerns about the effects of State regulation on the national economy, end quote. Well, our national economy is an area where the U.S. leads the world, but we are also number one when it comes to the complexity of our State sales taxes. Number two is the European Union, who has just 27 VATs, but our 46 States are approaching 10,000 jurisdictions, and each gets to have up to two different tax rates, yet this legislation endorses this State tax disaster and it forces businesses in other States to comply.

Question, would it be fair and equitable if Congress passed this Marketplace Equity Act? First, would it be fair to senior citizens who use catalogs and mail checks with their orders? Here is a catalog, Mr. Chairman, from National Wholesale established in 1952 in North Carolina, and with 200 employees today. They sell sensible clothing and shoes for senior women. The average age of their customer is 70years old, and 40 percent of them pay by check with a mail-in. National collects sales tax for North Carolina but not for customers in other States. It just isn't fair to ask a grandmother to fill out this form in a way that causes her to search through 46 different States and thousands of jurisdictions to find the tax rate applying to her and put it on her form.

Second, would this bill be fair to a small business? This bill has a $1 million small seller exception, but that is not nearly high enough since $1 million is just a tiny little operation, and let me explain. Out of a million in gross sales, that business is going to pay $750,000 or so for cost of sales, they will pay $70,000 more for marketing, advertising, travel to trade shows, 60K for computers and programming and web site, another $50,000 for supplies, insurance, shipping, and accounting. If there is anything left, they might be able to pay an employee or two. A million retail sales is still just a mom and pop operation, and it is not fair to hit them with new costs for software, customer support, and accounting.

What is a more reasonable small business exception? Take a look at the top 500 e-retailers. They account for 90 percent of the uncollected sales tax last year. Number one was Amazon at nearly $50 billion, number 500 was a small firm at $15 million. You could spare businesses on that long tail to the left of the $15 million and still let the States collect 90 percent of their tax.

So, third, would it be fair to a business who is just big enough to get over the small threshold? A one-State business would be forced to pay for all States. They need radical simplification and they need reduced administrative burdens, but this bill leaves out true simplification. It is not fair, for instance, for a business in your State to have to file 46 different tax returns every quarter and be subject to 46 separate audits every year. These are just two of the eleven missing simplifications that we detail in our testimony.

So to conclude, really, these tax fairness bills aren't so fair after all, and they would unmistakably create a new tax on America's businesses. State sales tax is due from the business who made the sale, whether or not they pass the tax on to the consumers. Most States call it a business privilege tax for the privilege of doing business in their State. It is due from the business. So for businesses in every State, even States that don't have a sales tax of their own, this bill would authorize a uniquely complex and new tax burden.

So, in closing, please keep in mind the costs on American businesses if you were to empower States to export their tax burdens to external businesses. And please compare that to the potential new taxes which, at most, would be less than 1 percent of total State and local tax revenue. Compare those two, and I think you will conclude that the juice just isn't worth the squeeze, and I sincerely look forward to your questions.

[The prepared statement of Mr. DelBianco follows:]

Statement of

Steve DelBianco

Executive Director

NetChoice

Testimony before the

United States House of Representatives, Committee on the Judiciary

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

July 24, 2012

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Would HR 3179 create a new tax?

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

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

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

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

[5] *Id.* at 312 (emphasis added).

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

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

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

> "The Arizona transaction privilege tax is commonly referred to as a sales tax; however, the tax is on the privilege of doing business in Arizona and is not a true sales tax. Although the transaction privilege tax is usually passed on to the consumer, it is actually a tax on the vendor." [7]

> California: "The sales tax portion of any sales and use tax ordinance adopted under this part shall be imposed for the privilege of selling tangible personal property at retail" [8]

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

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

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

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

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

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

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

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

Unique Tax Jurisdictions

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Isn't there increased momentum to overturn Quill?

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

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

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

Why would Amazon.com support overturning Quill?

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

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

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

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

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

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

Is this debate really about "fairness"?

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

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

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

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

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

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

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

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

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

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

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

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

some walk-in trade, but most sales come from their web store and other online channels.[16] Online sales growth enabled SilverGallery to buy their building and increase employment, right there on Main Street.

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

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

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

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

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

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

[17] *Available at* http://www.netchoice.org/wp-content/uploads/cost-of-collection-study-sstp.pdf.

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

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

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

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

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

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

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

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

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

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

HR 3179 does not include adequate protection for small businesses

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

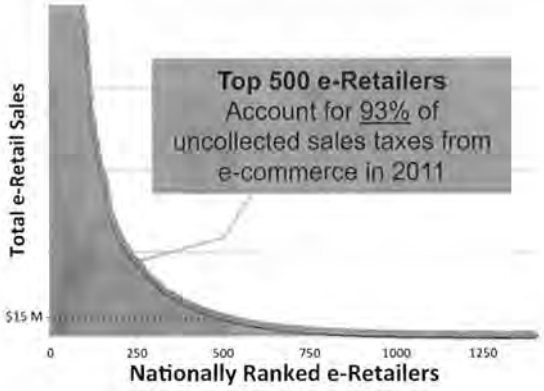
- $1 million in gross sales times 25% average gross margin leaves just $250,000 to cover all costs of running the entire business.
- Those costs include advertising, rent, supplies, insurance, shipping, computers and programming, website, accounting, communications, travel, etc.
- If there's anything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

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

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

Economists Eisenach and Litan started with this Top 500 Guide when analyzing where each retailer already collected sales tax under Quill's existing physical presence standard. Using their analysis, we

estimated that the Top 500 were responsible for 93% of the uncollected sales tax on US e-commerce in 2011, as shown in the graph below[20] (netchoice.org/top500collect).



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

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

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

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

Minimum Simplification Requirements lacking in HR 3179:

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

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

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

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

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

HR 3179 fails to hold states accountable to simplification requirements

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

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

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

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

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

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

Conclusion

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

Mr. SMITH [presiding]. Thank you, Mr. DelBianco.

Governor Haslam, let me direct my first question to you. And it is this: If this bill, H.R. 3179, were to be enacted, it is obviously going to generate a lot of additional revenue for a lot of States. What do you think is going to happen to that revenue? Is it going

to in some form be passed along to consumers—perhaps a lower sales tax—or is it simply going to be spent by elected officials?

Governor HASLAM. That is a great question. It is one of the beauties of the State systems. I think you will see 50 different answers to that question. In our State, I think we would use it to do a variety of things. I think our history has been since we have been in office we have cut taxes both years. And so we would probably lead with that. That being said, would we apply some to infrastructure, yes? Would we look at trying to mitigate some of the rising costs of higher ed? I know you all have looked at that in Congress in very serious ways. My sense is the honest answer is there would be a myriad of ways that money would be used. I think, in our State, part of that would be used to cut taxes.

Mr. SMITH. Thank you, Governor.

Mr. Harper, the SSTGB that you represent has done good work to make taxes simpler and easier to comply with. Do you believe the simplification requirements built into this bill comport with SSTGB's benchmarks?

Mr. HARPER. I do. There are a lot of good safeguards that are built into this bill. I would like to see some additional ones that would provide the security and the surety to small businesses and retailers. But I think this goes a long way to addressing the issues.

If I may follow up on Governor Haslam's comment to your first question, I have a bill file opened in the State of Utah, with the anticipation that this bill or the Senate bill will pass that will go through and reduce the State sales tax rate and basically have this as a revenue-neutral impact to the State of Utah.

Mr. SMITH. Thank you, Mr. Harper.

Mr. Kuttner, do you have any alternative ideas—and I regret I missed your testimony. You may have mentioned them in your testimony. Do you have any alternative ideas to level the playing field between the online and the bricks and mortar retailers that are not in the bill that we are considering today?

Mr. KUTTNER. Well, it would bother Governor Haslam here a lot, but a different way to approach the problem would be to say that there are certain categories where online sales have become so great or that the competition is so intense it is only unfair that the State should just not tax those categories. But I think that is going to make his life a little more difficult. But it does answer your question about another way you can get at this, which is to narrow the sales tax base to exclude certain categories.

Mr. SMITH. Thank you, Mr. Kuttner.

Mr. Henchman, many proponents of this legislation claim that there is software available to facilitate tax collection by remote sellers, thereby alleviating the burden on interstate commerce that concerned the Supreme Court in *Quill*. What is your opinion as to how well that software works?

Mr. HENCHMAN. It can facilitate the lookup of rates. But rates aren't everything. Indeed, generally zip codes do not align with sales tax jurisdictions. So that is a problem. Just as one example, there is a zip code that straddles the line between California and Oregon. Oregon has no sales tax. California has very high sales tax. If you put in the zip code, that is not going to tell you the complete story.

But even putting aside just rates, the question of what is taxed and what is not is often a question of reading the revenue rulings and trying to figure it out. It is often unclear. Just as one example, in my testimony I pull from a colleague's work who tried to see whether a bottled Frappuccino drink will be taxed under sales tax statutes. Some States they are, sometimes they are not. Some States it is unclear. There is a lot of work that can be done to simplify that software isn't going to solve. This is a legislative problem at the State level.

Mr. SMITH. Mr. DelBianco, that is your question, too.

Mr. DELBIANCO. I am amazed at the claims of software making everything so simple. I made my living building software, a lot of it point of sale and back office systems.

The Governing Board of the Streamlined Sales Tax paid a million dollars for PricewaterhouseCoopers to do a study of what does it cost American businesses today, under the current rules, to collect sales tax. They concluded the businesses at a billion dollars in sales were spending 17 cents of their own money to collect the sales tax for the one or two States they collect in. And of that 17 cents of their own cost, only 2 cents had anything to do with software. The rest is for the cost of handling exceptions and problems and questions, following up on audits that are done, following up on questions from consumers about nontaxable items.

There is nothing to the beauty of software for doing a lookup. But let's not kid ourselves. Software doesn't plug and play into some back-office system or custom fulfillment system.

There is a Virginia seller called The Silver Gallery, who studied what it would cost them to modify their fulfillment system. They are about a $3 million seller of jewelry and a lot of engraved items and pewter. They have a custom system to allow the consumer to specify their order. They will spend $15,000 to $20,000 to integrate free software into their existing systems.

Mr. SMITH. Thank you, Mr. DelBianco.

Mr. Harper, do you want to comment on the software question?

Mr. HARPER. Yes. Since that PricewaterhouseCoopers study was done a number of years ago, there has been a number of additional players who have come to the table with software. Back then, I think there was two or three. There are at least eight that are on the table today. The software has vastly improved.

Some of the things that are being worked on through the Streamlined Sales Tax is a jurisdictional database, a State certified collection of software, vendor compensation, things of that nature, that will go through and ameliorate the burden that can placed on business. So I think some of those issues are truly answered today.

Mr. SMITH. Thank you, Mr. Harper. That concludes my questions, and the gentleman from Michigan, Mr. Conyers, is recognized for his.

Mr. CONYERS. Thank you, Chairman Smith.

This seems to be a question that starts off with a great deal of excitement about us finally dealing with our obligation in *Quill*, but then it comes down to whether there is technology sufficient to make this practical. How can, I ask Governor Haslam and Governor Harper—wait a minute, Harper is not a Governor.

Mr. HARPER. Representative, please.

Mr. CONYERS. Yes. Not yet. But how can we accommodate the particularly practical objections that have already been raised by Mr. Henchman and Mr. DelBianco? How do we deal with that end of the table of witnesses?

Governor HASLAM. I would say a couple of things. First of all, that is what American industry does best. The progress we have made on being able to track those sales from when the Supreme Court decision was made is night and day. That is the first thing.

The second thing, I do come back, despite some of the testimony, it is really not fair. We are saying it is fair for everybody that has a retail presence. But everyone doesn't have a retail presence. The reality of the fact is you have local businesses contributing property tax and sales tax and jobs that are having to play on an unlevel playing field. We have to figure out a way to make it work.

Mr. CONYERS. Yes, sir.

Mr. HARPER. Thank you. And I think the question and the response from my two other witnesses over here is exactly why we want to have this legislation passed. We have nearly 10,000 jurisdictions in the country. If we go through and require one return in each State and one audit in each State, as is what is being promulgated by the Streamlined Sales Tax Organization, that is a significant reduction on business.

J.C. Penney has hundreds and hundreds of accountants that respond today to sales tax returns and sales tax audits from thousands of jurisdictions across this country. Imagine what they and other retailers could do if we had a single audit, a single return each month, that could be reduced and they could focus on the core business of developing and designing and selling goods.

Mr. CONYERS. Thank you.

Mr. Kuttner.

Mr. KUTTNER. I guess I am the man in the middle here between the two sides.

The emphasis I would have is on the innovation and this very steep curve we are on here where we have gotten since 1992, since *Quill* and where we have yet to go. So the fact that this technology isn't quite there, there are going to be new entrants into this field. And as an associate of mine put it to me, Isn't there an app for this yet? If not yet, there will soon be a group of folks sitting down trying to get the app worked out that will make the solution on somebody's iPhone.

Mr. CONYERS. Well, this can be improved. The bill isn't perfect. Most bills, when they are finished, they are not perfect, much less when they start out.

But, Mr. Henchman, do you have any suggestions about where we might start in on the improvement of this measure before us?

Mr. HENCHMAN. Certainly. I agree with you that technology is a concern, but also how far States have to simplify under this legislation is important, too. Maybe the two can meet in the middle.

One example in this bill that I think is a great feature is the option of using a blended rate, a combined State and average local rate. That way, retailers are just dealing with 46 different jurisdictions rather than 9,600. That is a feature unique to this bill, not in some of the other competing legislation. There are, however, some features that are not in this bill that are in some of the other

bills. I go through those on page 16. Maybe including some of those might further make sure that the system that we foist on online retailers and that national retailers currently have to deal with can be a lot simpler.

Mr. CONYERS. I think that this Committee and another Committee in the Congress have a lot of work to do. I am willing to begin that because I think the fairness issue

overrides everything that we are here for. There are problems, and I would like to invite all of you to help us work them out.

Thank you, Chairman Smith.

Mr. SMITH. Thank you, Mr. Conyers.

The gentleman from North Carolina, Mr. Coble, is recognized for his questions.

Mr. COBLE. Thank you, Mr. Chairman.

Gentlemen, good to have you all with us this morning. As the distinguished Ranking Member pointed out, we have been kicking this issue around in excess of a decade. And we may be standing in the shadow of being close to a resolution. I hope so.

Governor, let me start with you and work our way down the table with a two-part question. Rhetorical question, I think, but I still would like them on the record.

Will this bill create a new tax, A?

Governor HASLAM. No.

Mr. COBLE. And B, is it feasible for Internet retailers to collect and remit State sales tax?

Governor HASLAM. No, it won't bring a new tax. It is a tax that is already owed. It is a sales tax that is paid—when businesses put their P&Ls together they don't show sales tax owed and sales tax paid. It is due from the buyer. That is number one.

Number two is the capacity to do this. I really do. I understand there are issues and I understand different jurisdictions, I understand there are sales tax holidays in different places. But given the capacity that we have today, I am very confident that we can solve these issues.

Mr. COBLE. Thank you, Governor.

Mr. Harper.

Mr. HARPER. No, this is not a new tax. What we are asking for is Congress to authorize a collection tool. Is the software perfect out there? No. As we continue on, improvements will be made. Bright eyes and bright minds will see things and make changes that will facilitate the improvement in the software. But it has come a long ways, and I think it is really for trial and for congressional authorization now.

Mr. COBLE. You think it, therefore, is feasible for Internet retailers to collect and remit?

Mr. HARPER. Yes. Because everything that is needed to be told to a State tax authority is already being provided by the consumer in their shopping cart.

Mr. COBLE. Thank you, sir.

Mr. Kuttner.

Mr. KUTTNER. Is it a new tax? No. It is an

uncollected tax often, but it is not a new tax. Is it feasible? Yes. Is it a burden for some small entities? Perhaps. That is a question

to be decided on. It is an empirical question, not a question of feasibility.

Mr. COBLE. Thank you, sir.

Mr. Henchman.

Mr. HENCHMAN. On the question of whether it is a new tax, it is an existing tax that is not paid by the vast majority of people who should be paying it. Whether that is a new tax or not I think is in the eye of the beholder. I think a lot of people will see it as a new tax.

As for the question of whether it is feasible, I would agree with Mr. Kuttner's point. The question is not really feasibility but how burdensome will it be and how much can congressional legislation reduce that burden.

Mr. COBLE. Mr. DelBianco.

Mr. DELBIANCO. Thank you, Representative Coble. On the first question, it is absolutely a new tax. It is the use tax of consumers that isn't being paid. And what they want you to do is to allow the States to force sellers to pay a sales tax. Sales tax is the flip side of the use tax. And when a sales tax is due, it is due from the business, it isn't due from the consumer. The business has to pay it, whether they collected it or not.

In your State, National Wholesale has a line item on their order form to put in the sale tax. If grandma puts the wrong amount in or leaves it blank, National Wholesale pays the sales tax. They can't tell the State that, I'm sorry, she didn't pay her tax. It is due and payable with penalties and interest from the sellers. That is why it is called a sales tax or a privilege tax. It is not called a consumer tax.

Mr. COBLE. This is obviously subject to interpretation. I, again, thank you all for being with us.

I yield back, Mr. Chairman.

Mr. SMITH. Thank you, Mr. Coble.

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

Mr. SCOTT. Thank you, Mr. Chairman.

Mr. Chairman, I think we have heard comments and your questions pointed this out, the logistics of collecting this tax can be absolutely impossible, particularly if people are coming in and mailing in orders from all over the country. You may owe tax to one little jurisdiction and have to account for all of that.

But, Mr. Harper, the last time we had a hearing like this did I understand that there is a service that can be provided that would assess and calculate the tax, just like it is done now on shipping, just stuff where it does it for you and the business can collect the tax and send one check to the service and the service will figure out who gets what? Was it you that testified the last time we had a hearing like this?

Mr. HARPER. No, it was Senator Luke Kenley from Indiana.

Mr. SCOTT. Did I describe it right, where you just get the software, put it on, and it does all the calculation for you. You write one check to the service.

Mr. HARPER. There are certified service providers that do have and do offer software that can go through and you can use them as a third-party, if you choose, and they will go through and remit. So you can just run it all through them. Or, some of the larger

companies will do it on their own. But there are existing software companies who will handle it for you.

Mr. SCOTT. And what is the cost of that service?

Mr. HARPER. The cost of the service depends on the company. The intent through the Streamlined Sales Tax is that vendor compensation will be provided so that the company will not have to pay for that.

Mr. SCOTT. Say that again.

Mr. HARPER. Okay. The intent of the Streamline Sales Tax is that there will be vendor compensation so that the retailer will not have to pay for it. It will come out of the tax that is collected as a compensation tool.

Mr. SCOTT. So that just like you collect the handling and shipping and the software plugs in the number, for no cost to the business you can get the software that will provide the calculation of the tax and you write one check to the service and they will figure out where it goes?

Mr. HARPER. Yes.

Mr. SCOTT. And it is not cost to the business. Is that right?

Mr. HARPER. Yes. That is correct.

Mr. SCOTT. Now if there are problems with what is taxable and what is not taxable, does the software deal with that, too?

Mr. HARPER. Yes. For those members of the Streamlined Sales Tax project or program there are definitions of every product that is out there and then States will choose what is taxable and not taxable based on the definitions that exist.

Mr. SCOTT. Is this by product code?

Mr. HARPER. It could be by product code or by product type, yes. There is a whole bunch of data that you can turn on and on off. Yes.

Mr. SCOTT. Thank you.

Mr. DelBianco, you indicated that if your Internet is based on the person's residence of bricks and mortar based on this location—and the last time had this hearing we also had another category—if the product was purchased from a brick and mortar but delivered somewhere else; if you buy it in D.C. and deliver a washing machine to Virginia, that Virginia can get a tax. Is that right?

Mr. DELBIANCO. In a situation like that, if their own delivery trucks are delivering the good to Virginia and the purchaser lived in Virginia, well, then the D.C. company would have to collect or remit the Virginia sales tax. That isn't the situation, though, that we are talking about here, because you compared the ease of calculating shipping and handling suggesting that makes it easy to do sales tax. But it isn't the case. Think about when a sales tax comes in on an address, the seller has to know is there a sales tax holiday in this day in that State.

Mr. SCOTT. I totally agree with you if the seller was actually making the calculation. Mr. Harper has suggested that the software would figure that out for you. And it plugs in just like the shipping fee.

Mr. DELBIANCO. May I follow up on that? Let's assume that free software, if I put in an address and a product code, can return a rate. But that is where my problems just begin. Because I now need to know was the payer, the person that bought it, a tax ex-

empt person. Their own study shows that a lot of the costs of collecting sales tax has to do with figuring out whether the person purchasing it is an exempt purchaser. What about whether the item is taxable or not? Consumers get on the phone and call and say, Why is this item being taxed in my State?

Refunds and exchanges are the beginning of the expense because every time a product is changed out in a refund or an exchange or a back order, that has to make adjustments to the system, and finally the audits; 46 State audits.

Mr. SCOTT. Let me let Mr. Harper respond to what that software does with people who may be taxable or not taxable.

Mr. HARPER. There is a taxability matrix in there and yes, you can go from, say, this is taxable, it is not taxable, we have got jurisdictions, we have got sales tax holidays, all those things built into the software. So I believe that have there is the functionality to address the issues which cause you concern.

Mr. SMITH. Thank you, Mr. Scott.

The gentleman from California, Mr. Gallegly, is recognized for his questions.

Mr. GALLEGLY. I thank the Chairman very much. I have to commend the Committee on putting together what I think is one of the more balanced panels that we have had in a long time. There has certainly been an interesting diversity in the testimony. And like so many cases, we always kind of get back to this fairness issue. Clearly, fairness, when you put five political people together—or variations of political people together—the fairness sometimes becomes a tad subjective.

I am a Republican. I was a former mayor. And I have been a member of the Chamber of Commerce for over 40 years. I am having a little problem with the Governor's assessment of it not being a new tax. When you have to pass a law to tax somebody, a tax they are not paying, to me that seems as though it is a new tax. Is it a fair tax? Well, that is where the subjectivity comes.

Now, I would like to ask Mr. Henchman a question, maybe Mr. DelBianco or maybe even the Governor would like to respond to this. The source, the provider has got a business set up. Pays for the business. The State, county, also local jurisdictions get a percentage of sales tax. These are the folks that are providing the service in the State where this product is made. It would seem to me that if we had a uniform tax on this type of a transaction, States that are charging 2 percent would charge 2 percent to every consumer; a State that charges 8 percent would charge 8 percent to every consumer that opts to buy in that State. The provider would only have one sales tax percentage to work with.

I would like to get a response from Mr. Henchman first, and then perhaps Mr. DelBianco, about the point of origin, maybe, if we are going to go this direction. I am still wrestling. It has been a topic of discussion for a long time.

Mr. HENCHMAN. I think you might mean Mr. Kuttner. He has written papers on it. But it is not the approach taken by this bill, though.

Mr. GALLEGLY. Well, I understand that, but that doesn't mean that there might not be amendments during the course of it.

Mr. HENCHMAN. Sure. The issue you might be concerned about, at least when I describe it to other people, is: Are all Internet businesses going to flee to States with no sales tax. We don't all flee to States with no individual income tax. Businesses don't all flee to States with no corporate income tax. But maybe it is different for this.

Mr. GALLEGLY. Well, it might not be a bad idea for people to do things to create business in their States to lower the taxes. I would vote for that.

Mr. DelBianco, your assessment?

Mr. DELBIANCO. Thank you, Congressman.

What you described, the notion of assessing the taxes strictly based on where the item is sold from, is essentially what brick-and-mortar stores do today. They don't have to ask where you live, even though you are taking the item home with you; they don't have to calculate the rates where you live, they don't have to file returns for other jurisdictions. They all presume that you are using it right where you bought it. And that simplicity is the same simplicity that ought to be applied if we decide to force

out-of-State sellers to collect. So I think you are on to something there. We may need to turn this destination-based system upside down and take a hard look at an origin-based tax system.

Mr. GALLEGLY. Mr. Kuttner, you have written on this. So if you could be brief enough that I could hear from the good Governor over there.

Mr. KUTTNER. An origin-based approach is much more complex. It has a lot of added complexities that need to be thought through. Where is the origin? Is the origin for a company going to be where the good is shipped from, is it going to be where that corporation's headquarters are located, if it happens to be in a different State. And the question of imports. Is anything that is imported to the U.S. sold from outside the U.S. therefore going to become

tax-free because it does not have any origin inside the United States. That is the kind of questions that come up as one thinks about origin.

Mr. GALLEGLY. But it would appear that the challenges that you have just presented might be a little simpler to work with than 48 different taxes from 48 different States, just my own assessment of that, which I stay open with.

Governor.

Governor HASLAM. While I very much appreciate and sympathize with your view that let's incentivize people to go to where the taxes are lowest, remember, States have a different mix of taxes. Some, like us, have no income tax so they rely more on sales tax. There is a variety of different approaches so you are going to be incentivizing folks to locate one place due to one particular tax.

Mr. GALLEGLY. Thank you, Governor.

I see my time has expired. Just a brief response to the Governor. Unlike California, we have got high taxes on everything—income tax, sales tax, property tax. You name it, we got it.

Governor HASLAM. We find your State to be a great place to recruit.

Mr. GALLEGLY. And many have been doing just that.

Thank you. I yield back.

Mr. SMITH. Thank you, Mr. Gallegly.

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

Mr. WATT. Thank you, Mr. Chairman. I keep wondering when my friend from California is going to export himself from California.

Mr. Kuttner, listening to your testimony, at least before I heard Mr. Henchman and Mr. DelBianco, I was tempted to think that maybe innovation is taking place so rapidly that you wouldn't need the $1 million exemption or the hundred thousand dollar exemption that this bill does because you could just pull up an app and it would be done pretty simply. That is where we are headed, isn't that right?

Mr. KUTTNER. The technology is going to reduce the cost over time. As to where the threshold goes, that is a question for you to decide.

Mr. WATT. Well, this is a good panel because you have got divisions. Mr. Kuttner doesn't seem to have a dog in this fight. He can go either way.

Mr. HENCHMAN. We sat in the right order, too.

Mr. WATT. Mr. Henchman seems like he could go either way if you simplified the tax. You are not saying this is a bad idea. You are just saying it would be a lot simpler if you simplified the tax.

Mr. HENCHMAN. It would be simpler if you simplify, yes.

Mr. WATT. Mr. DelBianco says he doesn't want this I don't care what—even if you simplified the tax I guess you think this is a bad idea.

Am I misstating where you are? You think it is fair the way it is?

Mr. DELBIANCO. Congressman, I have done I think what I hope to be a thorough job explaining how unfair it will be to collect. And that is why at the end of my testimony I burned two pages describing the minimum simplifications, the true simplifications under which it makes sense to require remote companies to collect.

Mr. WATT. All right. Well, let's look at some of those simplifications. I guess some of these are on page 16 of Mr. Henchman's testimony. You are talking about offering immunity to remote sellers who misapply sales tax holidays. Do we offer immunity to local sellers who miscalculate? I mean, we hold them responsible. Why wouldn't we hold remote sellers equally responsible if we are trying to apply the law to everybody?

Mr. HENCHMAN. Is that directed to me, Congressman?

Mr. WATT. Yes.

Mr. HENCHMAN. The rationale for that would be brick and mortar retailers just have to deal with the sale tax holiday that they are dealing with in their jurisdiction, whereas an online seller would have to deal with this year 17 State sales tax holidays.

Mr. WATT. What I am trying to get to is an equal application of tax, regardless of who is responsible for it. I don't think I would be more interested in giving somebody immunity from something that I am not giving, because then you are creating another disparity between in-State and

out-of-State collectors, it seems to me.

Do we compensate brick-and-mortar retailers for collecting the tax?

Mr. HENCHMAN. Many States do, yes.

Mr. WATT. You do. Do you compensate brick-and-mortar vendors in your State, Governor?

Governor HASLAM. Compensate in which way?

Mr. WATT. Compensate brick-and-mortar vendors who collect your tax; for collecting your tax.

Governor HASLAM. No, we do not.

Mr. WATT. Do you, Mr. Harper?

Mr. HARPER. Yes, we do.

Mr. WATT. How do you do that?

Mr. HARPER. We had a study that was done, cost of collection, and the businesses in the State agreed to it and we put it in the State Code. It is 3.12 percent of what is collected.*

Mr. WATT. So you think that would be a fair addition to this bill?

Mr. HARPER. Yes. There are some other things I would like to see in this bill for safeguards. But yes, vendor compensation as agreed to between the business community and the States would be good.

Mr. WATT. What about require local jurisdictions to align geographically with five-digit zip codes? Do you require that of brick-and-mortar retailers?

Mr. HARPER. In the State of Utah, we have a jurisdictional database, yes, and you go through and based on where the transaction occurs, that is where the tax is imposed. And I think that would be another safeguard for all States to have.

Mr. WATT. But if you are going to a State opting for one of these three options, as I understand this bill to do, what sense would that make?

Mr. HARPER. What it does is it allows each State to maintain control of their own State tax policy and to choose one of the options that best fits their State.

Mr. WATT. But once they choose one of those three options, aren't they basically foregoing all of the other variables within the State?

Mr. HARPER. It depends on what amendments are made, but in the present form they could be locked in. But I think that is still an item for discussion.

Mr. WATT. All right. I think I am confused enough, and I will yield back.

Mr. GOODLATTE [presiding]. The gentleman yields back, and the Chair recognizes the gentleman from Virginia, Mr. Forbes, for 5 minutes.

Mr. FORBES. Thank you, Mr. Chairman, and thank all of you for being here. This is a very important issue, and we appreciate your expertise.

Governor, we are all sympathetic with this issue. We are trying to work through the logistics with the best piece of legislation. One of the questions we have is I know that your State is one of a few States that uses the physical presence standard also for the imposition of business activities taxes. This Committee lauded that approach last year when it voted favorably for H.R. 1439, which was the Business Activity Simplification Act. That confirms the *Quill*'s

*Mr. Harper edited his response as follows: The figure I stated was, "It is 3.12 percent of what is collected." That was an incorrect figure. The current rate for vendor reimbursement to collect sales tax is 1.31 percent. That reimbursement is available only to businesses that file a monthly sales tax return.

holding and applies to corporate income and other business activities tax. I don't know if you had time to review that bill before coming or not to see if how we reconcile that with this particular piece of legislation.

Governor HASLAM. I am sorry, Congressman, I have not.

Mr. FORBES. And I wouldn't expect you to.

Mr. Henchman, I think you testified on that bill when it was here. Can you reconcile the two, this legislation with that?

Mr. HENCHMAN. Sure. Although it is an issue that you should be thinking about, the physical presence standard, as I mentioned in my testimony, is a cornerstone of State taxation, not just for sales tax but for individual income tax and corporate income tax for a long time, and the BASA bill and the Mobile Workforce bill seek to enshrine different components of physical presence for those two tax standards.

The way I, at least for myself, relate it to sales tax is the tax that we are dealing with here is one that is imposed on and has to be paid by the consumer, which does have a physical presence in the State, and the economists who work in my office tell me that they bear the economic burden of the tax, that while businesses collect it and they bear some administrative costs associated with it, the economic burden is passed forward to the consumer. The consumers do have physical presence in their State. So that is how I would reconcile it.

Mr. FORBES. Mr. Harper, what do you believe is the appropriate small seller exception threshold? Does this bill get it right? And is that something that we have pulled out because it is politically acceptable or is there some substantive reason why we would pick that particular dollar amount?

Mr. HARPER. This bill has a million dollar small seller exemption. The Senate bill has a $500,000. As we have talked about it with Streamlined Sales Tax, we believe that for the remote sales $500,000 is probably appropriate. But it is up to Congress to go through and weigh that out and come up with the final factor.

Mr. FORBES. Mr. Henchman, one of the concerns that some people have about this bill is that the small seller exemption carves out remote small businesses with less than a million dollars in sales into the State. It actually treats out-of-State small businesses much better than in-State because the in-State business still has to collect and remit the tax while the out-of-State seller does not. Is this a problem to you or how do you reconcile that?

Mr. HENCHMAN. Well, that is non-neutral treatment. Maybe if Mr. Watt had more time, that is what he might go to next, because that is a differential treatment between remote sellers and people within the State.

The list of possible simplifications, of course, don't all need to be done. Adopting one might obviate the need for another. So if we have a really simplified system, maybe we don't need a small seller exception. But if we are to punt on simplification, maybe we would need a really high level for a small seller exception. However, I don't know what the magic number is. There is no economic policy that dictates what the magic number is, but I think that is the balancing approaching the Congress should use.

Mr. FORBES. Mr. DelBianco, I am going to let you address any of those questions in your response, but also I would like for you to address—there is a concern that this is putting small mom-and-pop businesses in a very difficult position and that they are going to go out of business. How do you address that concern if we don't do something to

offset this?

Mr. DELBIANCO. I couldn't agree more. Small

mom-and-pop businesses on Main Street have been getting clobbered by Wal-Mart, Target, Amazon for over a decade now. And that impact has driven them as the last best hope to turn to the Internet to try to sell excess inventory, to try to reach customers that maybe never darken their doorstep or customers that bought once in their store and then traveled home. So the Internet turns outs for small business to be perhaps the only way they can survive against the competition that I spoke of.

Just as we are counting on those small businesses to create the jobs and help our economy recover, this bill would impose on those small businesses the obligation to collect not just for the only State that they are in now, but for all 46 States and all 9,600 jurisdictions. That, to me, is the ultimate opposite thing we should do to small businesses who use the Internet to compete and survive.

Mr. FORBES. Mr. Chairman, my time is out, and I yield back. Thank you, gentlemen, for your expertise.

Mr. GOODLATTE. I thank the gentleman.

The gentlewoman from California, Ms. Lofgren, is recognized for 5 minutes.

Ms. LOFGREN. Thank you, Mr. Chairman. This is a very helpful hearing. I think all of us want to make sure that we nurture small businesses, whether they are on Main Street or whether they are an Internet company.

I met recently with a woman who lives in my district who had retired from the tech industry she worked for. Her early twenties son got cancer and he didn't have any health insurance. She spent everything she had to save his life. And now she is running a little small business out of her living room. She thought she would be retired, but she used all her retirement to save her son's life. So I am thinking of her and people like her that are running little businesses out of their living rooms to get by and how is this going to impact them, as well as the empty store fronts that I also worry about. But I am mindful that I think the Big Box stores have done more to the little small businesses on Main Street probably than the little tiny Internet businesses. The Big Box stores, along with Amazon.

As I look through this, page 14, Mr. DelBianco, and page 16, Mr. Henchman, are very helpful because they are giving us things to think about if we are going to move forward on this. And you are right, maybe we don't have to do all of them.

But here is one question I had, Mr. Henchman, on your suggestion that we establish a single tax return for all taxing jurisdictions. With that are you suggesting that if it is 8 percent in California, it should be 8 percent in every city and county? What is your suggestion?

Mr. HENCHMAN. No. Just that there be one return that you have to fill out.

Ms. LOFGREN. I see.

Mr. HENCHMAN. So, for instance, California, where I think—- I am originally from California—maybe just shy of 100 different sales tax jurisdiction, rather than somebody selling into California repeatedly having to fill out a hundred different forms for all those——

Ms. LOFGREN. I see. Because our voters have approved sales tax increases, primarily for transportation. Also, our county hospital. And we can't overturn what the voters did.

Mr. HENCHMAN. Each one of those is a new tax jurisdiction in California.

Ms. LOFGREN. Have you looked at the software that Mr. Harper described?

Mr. HENCHMAN. Yes. It is expensive. I don't know how much of a budget your constituent with the living room business has for software.

Ms. LOFGREN. None.

Mr. HENCHMAN. But it is expensive. Now that may change as technology goes forward but, of course, the simpler we make sales tax systems by setting Federal standards, the cheaper that would be.

Ms. LOFGREN. We could make that available for free. We could require the State to make that available for free.

Mr. HENCHMAN. Right.

Ms. LOFGREN. Mr. Harper, is this software available

online so that the Members of the Committee can go try it out and see for ourselves?

Mr. HARPER. Yes. We have also had a number of demonstrations here on Capitol Hill.

Ms. LOFGREN. But we are all busy. We don't necessarily go to those. Can you give us the sites so we can play with it and look at it?

Mr. HARPER. I can provide that to you for each of the different companies.

Ms. LOFGREN. Thank you very much.

I am also interested in how we arrive at, as other members have mentioned, the small business exemption. And I think that the dollar amounts in the bills are somewhat arbitrary. Why wouldn't we use what the Small Business Administration says, for example, or what the IRS says is a small business instead of just the sort of arbitrary numbers?

Mr. HARPER. I think, if I may, the reason for the $500,000 and the million is because that is what Members of Congress, both of the House and Senate, have come up with. So we have responded to that rather than the other standards that are out.

Ms. LOFGREN. I guess if we are going to move forward on any of this, I would want to have some further examination of that because it seems to me the SBA's whole reason for living, I mean existence, is small businesses. And they have studied what is a small business in a particular type of field. We should be guided I think by that or maybe the IRS. I am not critical of my colleagues who have introduced these bills, but I think, as Mr. Conyers said, these

are starting points not ending points when a bill is introduced and maybe we should get some guidance from either the IRS or from the SBA on what in fact is a small business for the exemption.

And I would just close, sometimes we think a solution is going to solve problems and it won't. I was in local government for 14 years and I know that revenue is a problem. At the time I was in local government we talked a lot about catalog sales more than Internet sales. But when you buy something online, you have to pay postage. And if it is not a high-dollar item, the postage is probably as much as the sales tax would be in a lot of these States. So to think that the sales tax application is somehow going to—it is not just the sales tax. It is the availability of inventory in some cases.

It upsets me so much that brick-and-mortar book stores are closing. I love to go to book stores. And yet if you go, you can't get the book you want because the inventory is insufficient and you end up buying things online because as retail gets hit, the inventory decreases and it is sort of a death spiral. So it is not just Internet sales.

Anyhow my time is up, Mr. Chairman. I thank you for this hearing. And I think this is the beginning, not the end, of our inquiry.

Mr. GOODLATTE. I thank the gentlewoman. It may not be the beginning of the end, but it may be the end of the beginning.

Ms. LOFGREN. I meant the beginning of the inquiry.

I ask unanimous consent, Mr. Chairman, to put into the record a listing of the businesses who sent us letters—the letters are too voluminous—in opposition to the bill.

Mr. GOODLATTE. Without objection, the listing will be made part of the record.

[The information referred to follows:]

77 Businesses wrote 117 Letters in only 3 Days to ask Congress: "Do Not Impose New Tax Burdens" and to "Oppose HR 3179"

Abbott Cards
Adaptive Plastics Inc.
AmeriMark
Award Emblem Mfg. Co.
Back in Black
Barco Products (Geneva Scientific)
Bluestone Perennials
Boston Green Goods
Burgers' Smokehouse
California Mustang
Chattanooga Shooting Supplies
Chef's
Christian Book Distributors
Corrugated Plas-Tech
Crocs
Cuddledown
Daedulus Books
Demco
Deseret Book
Dover Saddlery
Dr. Leonards Healthcare Corp
Drs. Foster and Smith
Fahrneys Pens
Famous Smoke Shop
Figi's Gifts
Garnet Hill
Gardeners Supply
Geddes School Supplies
Global Direct
Global Informercial Services
Great American Business Products
Gumps
Harriet Carter
Harris Seeds - Garden Trends
Hathaway & Lane Direct
Hirsh Luxury
Hodges Badge
Holly Yashi
Icomm
Johnson Smith Co.
Junonia
J.W. Hulme Co
Magnetic Concepts
MidAmerican Motorworks
Miles Kimball
MyTana
National Safety Supply
National Wholesale
New Pig Corp.
Norm Thompson
Orchard Brands
OrderLogix
OrderMotion
Paul Frederick
pc/nametag, Inc.
Peruvian Connection
Plow & Hearth
Potpourri Group
Ripon Printers
Ross-Simons
Ryan's Pet Supplies
S&S Worldwide
Sensa
Sgt Grit
Southern Fulfillment Services
Stony Creek Brands
Systemax
Thane International
Time Life Direct
Tempu
Touch of Class Parke-Bell Ltd, Inc.
TravelSmith
Ulla Popken
United States Plastic Corp
Upbeat
Winston Brands
XSellResponse

Mr. GOODLATTE. And the Chair will recognize himself for 5 minutes to say that the gentlewoman is quite right, this issue did not start with the Internet. In fact, the Supreme Court decision that articulates the standard was a mail order case that pretty much predated any significant business being transacted on the Internet. And there are also telephone sales.

So it raise a question here that hasn't been addressed by any of you yet and I am wondering if any of you are concerned about the fact that this advantages foreign businesses. We talk about States not collecting sales taxes for businesses in other States, but what about Canada, Mexico, Caribbean Islands, Hong Kong, China, India? You can buy goods from a couple hundred different countries around the world and those countries, to my knowledge, are not going to be required and this law is not going to reach a requirement that they have to collect sales tax for the State in which the consumer is receiving the product.

Do any of you have a comment on that?

Mr. DelBianco.

Mr. DELBIANCO. Thank you, Mr. Chairman. You are absolutely true. If a consumer were bound and determined to find a way to avoid paying sales tax on that digital camera——

Mr. GOODLATTE. He doesn't have to be bound and determined. He could be going on the Internet and seeing an ad from a company in Canada and saying, Hey, I like their price and I am going to buy it from them.

Mr. DELBIANCO. So it is absolutely true, consumers, as Congressman Lofgren said, consumers go online for the variable choices they get, the lower prices, completely aside from sales tax. They don't actually go online to save sales taxes. There is no data that show that. In fact, there is more data to support the fact that people go online to research their purchases and then use that online research——

Mr. GOODLATTE. Anybody want to respond? I have got a limited amount of time.

Mr. Harper?

Mr. HARPER. Yes. This bill deals with State tax authority and the 10th Amendment. What you are talking about is a very valid issue but it is one that Congress has authority to deal with tariffs and imports and all the other dealings.

Mr. GOODLATTE. Absolutely right, but it may have the unintended consequence of enhancing—if you think a business outside a State isn't required under current law to collect sales taxes for that State, it may have the unintended consequence of enhancing the competitiveness of businesses outside of the United States.

Mr. HARPER. I am not going to disagree with that.

Mr. GOODLATTE. Let me ask you this. One of the concerns I have—and I am completely sold on the fairness issue. The gentlewoman from California makes a good point about offsetting cost of the shipping and handling charges that you encounter often on the Internet, but there are lots of different advantages and disadvantages of each type of way of doing business. And the fact that a brick-and-mortar business is required because they have a nexus with the State to collect that tax and a business outside of the State selling into the State doesn't have that nexus and therefore isn't required to collect it is unfair, and finding a way to address that is a desirable thing.

On the other hand, that business outside of the State—and I will direct this to Governor Haslam—it doesn't have any representation in the State in terms of the whole process that one undergoes to collect the tax. And I am not sure we have enough uniformity in

the legislation that we are holding this hearing on to say with confidence that a small business outside of your State could, A, feel confident they were going to be treated fairly by a State that might be aggressive in pursuing collection of taxes.

We encounter this with business activity taxes and other things all the time, States making businesses out-of-State having to dance on the head of a pin to comply with their laws. What recourse do these out-of-State businesses have if they don't like the particular laws that your legislature or a legislature of another State might enact which would require them to comply with that requirement?

Governor HASLAM. Ultimately, it is the free-market system. And they have customers in those States who are saying we desire their product.

Mr. GOODLATTE. But the businesses in Tennessee aren't operating under the free-market system. They are operating under the fact that they are represented by a local member of the State legislature who goes to Nashville and casts a vote on whether or not it is a fair way to make that business in Cookeville or wherever collect taxes for them. They don't have that representation if they are in Richmond, Virginia, or Indianapolis, Indiana, or anywhere else in the country.

Governor HASLAM. And I appreciate the shout out for Cookeville. I would say that is not really an Internet versus retail issue. That same thing could be true of a retail chain that had one store in a State and their headquarters are somewhere else. I don't know that that changes with this argument.

Mr. GOODLATTE. Well, the other concern I have about this is that I think we are on a road toward making progress on cooperation, but I don't think we are there yet. We have some States that have joined together with the Streamlined Sales Tax provision. But this law apparently lets a State that doesn't join into the Streamlined Sales Tax, which may have one definition of what is taxable, to nonetheless step in. And some of the largest States in the country are sort of flexing their muscles with this legislation—California, Texas, New York, saying, We want to able to do this, but we also don't want to change our sales tax rules to have some kind of uniformity for these interstate transactions that are taking place. And that is what comes back on the shoulders of the Congress, because we have the ultimate responsibility for writing laws related to Internet commerce, and doing so in a fair manner not only for those brick-and-mortar businesses but also for those small businesses that are at this point in time I think still confronted with a very complex, many thousands of multitudes more complex than a business in your State or another State knowing what that State's requirements and only having to meet the requirements of that State.

So I commend the author of the legislation and I commend all of you who are trying to find a way to simplify it, but I would urge you to work further to bring about more simplification in terms of a definition. Any State that wants to participate in this, they ought to agree on one definition. I would prefer to see one rate. Three rates is better than 9,000-some rates. But I would prefer to see something that made it simpler.

And let me say this with regard to small businesses. I am concerned about exempting them from this. Your local small businesses in Tennessee are not exempt from collecting the tax. And businesses out of State, if there is a million dollar-cap, or some other cap, why would you not want to grow your business beyond that. And when you do that, you are going to face an artificial penalty for doing so and having to change your system and collect a tax that you weren't having to collect before.

If we are going to do this, I think we ought to find a way to make it work and make it work for everybody.

At this time the Chair would recognize the gentlewoman from Texas, Ms. Jackson Lee, for 5 minutes.

Ms. JACKSON LEE. Mr. Chairman and the Ranking Member, I am thankful for this hearing and thankful to have the opportunity to plunge into I think an issue, as the gentleman from Virginia has mentioned, has been discussed for a number of years. Many of us come with backgrounds from local government, the city council in the City of Houston, after serving as a municipal judge. It is not a city manager form of government so in fact we write budgets and seek opportunities for providing revenue to our constituents or for services. Likewise, the State of Texas has a unique structure as well. And I think it is important, Governor, to note that Texas brags that it does not have an income tax and therefore is in the recruiting business.

But I would make the statement as well that States, except for the politics of it, have other unique measures. There are individual States with casino gambling of all forms, and certainly that goes to the nature of the constituency. There are lotteries that have exploded across America. And certainly there are opportunities there where States continue to look. It is a curious situation for me because I come from a State where we have had the opportunity to receive $40 million in Medicaid dollars that were rejected. So it makes it very difficult when you think of opportunities to secure moneys that are rejected, that you want to do something that may cause some concerns among your small businesses.

So in order to educate myself a little better, I am going to ask Mr. DelBianco and I will ask some of the other members as well an extensive question, if I might. First of all, I think it is important that we argue for tax simplification. And the underlying bill seems to strike a cord of possible overlapping confusion. And I think it is correct that we need to find a way to handle this, if by chance this bill passed and it is making it way through the deliberative process.

But the current State system is a morass of over 9,600 taxing jurisdictions. Many zip codes cover multitude taxing entities. An op ed in today's Wall Street Journal cites the Dallas-Forth Worth airport that in the State of Texas as being in six separate taxing jurisdictions. In addition, the definition of taxable goods varies from jurisdiction to jurisdiction. In one, a Snicker's bar is taxed as a candy while in another it is taxed as food because it contains peanuts.

It is obvious to me that even if we were to adopt the bill before us, we would still have a long way to go. What responsibility does the Federal Government have to businesses to ensure a seamless and inexpensive transition to this new tax collection system, if

adopted? And then would you also comment on the fact is this a new tax and would the *Quill* case be overturned. I hope others are listening because I am going to go to some others for that question.

I think my last point that I would like you to comment on is as I read the bill, it seems like it says $100,000 dollars in sales in-State, and collectively, a million dollars.

I would raise the concern of the lady in the living room with her business, but also a sufficiently small business that may have $1.2 million in business and is a small business and it would be an enormous burden to try and keep up with this new structure.

Would you comment, my friend? Thank you.

Mr. DELBIANCO. Thank you, Congresswoman. First, you asked about the path on simplification. As Chairman Goodlatte pointed out, the bill before you only has three elements of simplification, whereas Congress has considered as many as 16 minimum requirements. And it is Congress' job to impose bold and robust minimum simplification requirements before it sweeps away the protection of physical presence.

Within this bill, two of them are fundamentally flawed. On definitions, this bill permits each State to have its own definitions. It doesn't even require all the States to use the same. This bill also says that each State can provide its own software to each and every seller. So imagine the seller having to take 46 different pieces of software, because this bill doesn't require that they all be the same.

You also asked about is it a new tax. As we have discussed earlier in this hearing, it is absolutely a new tax burden on businesses to collect it. The tax is due and payable from the business. It isn't due and payable from the consumer. In your State of Texas, your State tax collectors boldly said that Amazon has had a physical presence in Texas. So therefore you should have been collecting for the past couple of years. Your State sued Amazon for $290 million. Amazon couldn't turn around to you and say, Well, the consumers didn't pay it so we don't have to pay it. Because the tax is due from the retailer, in all cases, with penalties and interest.

Fortunately, your State used that as a bargaining chip to get Amazon to keep its distribution center in Texas. So under the physical presence rule we have today, Amazon will begin collecting in Texas next year, and there goes a lot of what you thought was the uncollected sales tax.

So does it overturn *Quill*? In a way, it completely blows away *Quill*'s physical presence standard. *Quill* always said that Congress has the right to do that. We know you have the right to do it, but is it the right thing to do.

Ms. JACKSON LEE. Can I just ask the Governor, do you think the exemption is high enough for small businesses and do you hear my underlying premise that it is a strange number because you could be small and go over the limit?

Governor HASLAM. Right. I don't know that I am qualified to define what that is. Like I said, one bill said $500,000. One is at a million. I do hear your underlying premise. It is worthy of discussion. Obviously,

Internet-based businesses are a little less labor intensive. So you have to be a pretty large Internet business to be over a million because of the smaller size of employees.

Ms. JACKSON LEE. Just a tiny question. You believe in states' rights. Isn't this a case of nullifying State laws?

Governor HASLAM. No. Actually it is just the opposite. I think what you are doing is giving States the rights to force businesses to collect that tax that is already due them.

Ms. JACKSON LEE. Well, I thank the Chairman for his indulgence. I read it differently. And I think we will have a long time for discussing and reviewing this matter, Mr. Chairman.

Mr. GOODLATTE. I thank the gentlewoman.

The gentleman from Texas, Mr. Poe, is recognized for 5 minutes.

Mr. POE. Thank you, Mr. Chairman. Gentlemen, thank you for being here.

As mentioned by my colleague, Ms. Jackson Lee, in Texas we don't have an income tax. We are proud of it. And if any public official advocates an income tax, they are a former public official. Republican, Democrat, or Independent. So our main source of revenue is property taxes and the sales tax. Businesses collect sales tax. We have a pretty good system, I believe. It has been worked on for a great number of years as to the exemption, the exceptions, and who pays and how it is collected.

I think States ought to have the right to collect a sales tax. And the Federal Government should not prevent them from collecting a sales tax. I think it is a states' rights issue, as you mentioned, Governor.

We have heard the stories about Best Buy. So this weekend I went to a Best Buy in Houston, Texas, and talked to the folks that worked there. I learned a lot of things. First of all, unfortunately 50 Best Buy stores have gone out of business this year. One of the reasons, they say, is because they are competing with someone that is not in Texas. And they pointed out the fact that customers come in, they get this free advice about all these electronic gizmos that I know nothing about, and as they are walking out the store they order it online and reap the benefits of the expertise of the store that is in Houston and they get this big monster TV sent to them. There are other stories about—because they don't pay the tax. They save that 8¼ percent and they aren't paying that tax and they get it for a bargain. That kind of bothers me that people would do that, but they do.

And we have the problem also of small businesses. I mean, am talking about small business. It is one store, mom and dad or cousins or whatever own one store.

And they have to compete with people online. It costs more to run a one-business store operation than it does a chain, of course, and there are events that take place with these small businesses that are out of everybody's control, including the government. We call them hurricanes. Just since I have been a Member of Congress in my congressional district, we have had the experience of Katrina, Rita, Humberto, Gustav, and Ike. When Ike came through Dayton, Texas, it destroyed, eliminated businesses to the ground because of the winds and the rain. It is an expense that they have to incur to rebuild that small business. Western Auto in Dayton,

Texas, is a perfect example. I don't know how many Western Autos there are in the country, but there is one less in Dayton, Texas, until they rebuild it. All of those are because they have a presence in the community. Going back to Best Buy, they have a community outreach employee that is working with the community, doing things for the community, donating money and time to Big Brothers, Big Sisters, all these organizations because there is a presence.

So but I understand the online operation and why it works and why it is successful, so, Governor, I want you to, if you would, before you drink that glass of water, expand on why you think we need to have the ability, States need to have the ability to collect a tax that is already due the State as opposed to, as some have said, this is a new tax. Can you explain the difference between the concept this is a new tax versus States are just collecting the tax that hadn't been paid for years because they weren't allowed to collect it. Can you expand on that please, sir?

Governor HASLAM. Right. Well, I mean, as we have said, it is a tax that is due, and I respect the gentleman on the other end, but when Amazon is sued, I don't remember the exact, sued by the State of Texas, I am betting that they sued them for not collecting that tax, I am betting that is what they sued them for. So it wasn't the tax that they were due, it was that they weren't collecting that tax. The *Quill* decision gave Congress the right to specifically address that, and to your point, you know, I keep coming back, it is basically an issue of fairness. It is some people pay it and some don't, and, again, as a former mayor, when that Western Auto went away, you didn't just lose the sales tax, you lost the property tax that it is paying——

Mr. POE. And jobs.

Governor HASLAM [continuing]. For basic services, and jobs. The same thing with that Best Buy. It ultimately comes down—I understand all the issues that have been talked about. It is very complex. But it is too big of an issue of fairness not to address.

Mr. POE. And you don't buy your boots online?

Governor HASLAM. I don't buy my boots online.

Mr. POE. Neither do I.

Governor HASLAM. We have a lot of great stores in Nashville, though, come on down.

Mr. POE. So do we in Texas. Mr. Chairman, I will yield back the balance of my time. Thank you.

Mr. MARINO [presiding]. Thank you. The Chair recognizes the gentleman from Georgia, Congressman Johnson, for 5 minutes.

Mr. JOHNSON. Thank you, Mr. Chairman. I would respectfully disagree. I think this is a new tax, and it is not simply a tax that is due. I think technically what we are doing here is imposing or we are seeking the ability of States to have the authority to impose a sales tax on Internet, on the sale of Internet goods. So it is a new tax for those who purchase their goods on the Internet and who don't, up to this point, have to pay taxes on that. I don't think there should be any disagreement with that.

Am I correct? Anybody disagree? Yes or no.

Governor HASLAM. I disagree.

Mr. JOHNSON. You disagree, okay. Well, I tell you. I want to say right now that I am in favor of the Marketplace Equity Act of 2011.

Having been a local elected official, a county commissioner, Chair of the Budget Committee, you know, I understand the unfunded mandates that have to be met that are imposed by the Federal Government, I understand the dwindling amounts that are collected through property taxes and also sales taxes on brick and mortar, and so as a fundamental issue of fairness I think it is only right that our, everywhere from our big box retailers down to our small mom and pop operations should be treated fairly, should not be discriminated against in tax law based on the fact that they have a brick and mortar location and a presence in a particular location. So I am in favor of this legislation, but I feel the specter of Grover Norquist in the room, and so therefore I feel compelled to ask, Governor and Representative Harper, whether or not you, too, as Republican State elected officials have signed on to the Grover Norquist "read my lips no tax" pledge? Have you signed on to it, Governor Haslam?

Governor HASLAM. I have not.

Mr. JOHNSON. Okay. And how about you, Mr. Harper?

Mr. HARPER. I have not because I am accountable to the people who elect me, not to Grover Norquist.

Mr. JOHNSON. Well, I fully agree.

Mr. Haslam, how come you didn't sign?

Governor HASLAM. In the end I think people judge you by what you do. In the State of Tennessee since I have been Governor we have cut taxes four times. I think actions speak louder than words.

Mr. JOHNSON. And, Governor, I know that you have said you disagree with me that this is not a new tax, and we could get caught up in semantics, but you did say that $400 million in lost tax revenue——

Governor HASLAM. Right.

Mr. JOHNSON [continuing]. Is incurred by the State of Tennessee. $20 billion for the Nation.

Governor HASLAM. Right.

Mr. JOHNSON. I can think of a whole lot of great things like police, fire, public safety, these kinds of needs that local governments are deprived of that tax money because of our inability, your inability to tax Internet sales, and that is why I support this legislation, but, you know, if Grover Norquist were to be sitting right here and he made the observation that, you know, by aiding or by supporting this act that you would be aiding and abetting the States in their ability to impose a tax increase on people who are not used to paying taxes on Internet sales, and therefore it is against the pledge, how would you respond to that?

Governor HASLAM. I would say to Mr. Norquist, I respect—I don't know what he would say on this, so I won't put words in his mouth, but my answer to that from whoever said it would be, no, we are trying to help a Nation of people right now that are breaking the law by not paying the taxes that they owe.

Mr. JOHNSON. Is it breaking the law?

Governor HASLAM. You don't pay a tax that is owed.

Mr. JOHNSON. Or is it skirting the law that there is?

Governor HASLAM. Well, we will quibble about that later, but——

Mr. JOHNSON. Okay. Yes, sir?

Mr. HARPER. And in that same vein, we have done surveys in the State of Utah, nearly three-quarters of the people in the State of Utah when they buy online or via catalog believe that they are already paying the sales tax, the use tax that is due. They are unaware of the fact that it is not being collected.

Mr. JOHNSON. Well, I guess when they become aware of it they will probably say read my lips, no new taxes. But maybe not.

I will yield back.

Mr. MARINO. Thank you, sir. The Chair now recognizes the gentleman from Iowa, Congressman King, for 5 minutes.

Mr. KING. Thank you, Mr. Chairman. So I am here listening to the testimony, and particularly that of Judge Poe from Texas, and he said do you buy your boots over the Internet. I had to stop and think for a minute, and I looked at the label of my jacket on the suit I have on, and I thought, well, I really do. Actually every suit in my closet is from Tennessee, and what I do is I go on the Internet, and I look at the inventory down at my local clothing store in Dennison, Iowa, Reynold's Clothing Store, and I call them up and say can you get me a couple of suits that meet this, and they have got my measurements and they order them out of Tennessee, and they do whatever tailoring is necessary to fit my figure, and they put it on UPS and ship it on up to Kiron, Iowa. Now, so I think I met all those standards, and I hope I pleased the Governor of Tennessee in the process.

Governor HASLAM. We are very grateful.

Mr. KING. And so this picture of what is going on with the free enterprise side of this, I have a letter that I am going to ask to be introduced into the record, but it is from Mark Jorgensen, and he is a co-owner of Carpet World Flooring in Fort Dodge, Iowa. There are many statements that have been made about brick and mortar and retail businesses and the costs and the point of the property tax that gets paid because of Main Street businesses. And he goes through that argument as well, like we have heard from the witnesses and other narratives. But he puts it in a fairly compressed way. He says the customer comes into my store to buy some hardwood and he wants to install it himself. We show him the samples and quote him $3 per square foot. He goes home and gets on the Internet and he is quoted $3.15, a higher price, but he buys it online anyway because the sales tax takes the price that he has to charge at the brick and mortar store to $3.21. I don't know what the freight works out, that is not in this narrative, but this little margin that turns out to be a 7 percent advantage that he has because of the sales tax in Iowa is generally 7 percent, and here is where he makes the point. He says my competition has not used his money to compete with me, he has used State of Iowa sales tax money to compete with me. That is the point I would like to emphasize here at this hearing is that we are all about competition, competition has made America great, free enterprise is one of the essential pillars of American exceptionalism. But when government competes or if you are in a position where you can use sales tax money as a competitive or comparative advantage, then you end up with people buying things over the Internet to avoid the tax purposes. So I just—but this has been examined really well by the witnesses and by the other members of this panel. So I have this other

thought that I wanted to inject into this, and I want to pose a question to the panel.

First, Mr. Chairman, I should ask unanimous consent to introduce this letter into the record.

Mr. MARINO. Without objection.

[The information referred to follows:]

Congressman Steve King
1131 Longworth Office Building
Washington D.C. 20515

7/22/2012

My name is Mark Jorgensen and I am a co-owner of a Flooring America store in Fort Dodge, Iowa. Thank you Mr. Chairman and Congressman King for allowing me to provide written testimony relating to the sales tax fairness issue.

As an Iowa retailer, I have been very concerned about the inconsistent and unfair application of sales tax laws as it applies to on line purchases.

Let me give you a real life example that is duplicated over and over daily in the marketplace.

A customer comes into my store to buy some hardwood. He wants to install it himself. We show him samples and quote him $3.00 per square foot. He goes home and gets on the internet. He is quoted $3.15 and he proceeds to buy on line. Although my price for product was less, I had properly added sales tax resulting in a cost of $3.21 per sq. ft.

I have built a building, stocked it with samples, hired and trained employees and my competitor gets a 7% advantage through an inconsistent loophole in sales tax law.

My competition has not used HIS money to compete with me; he has used State of Iowa sales tax money to compete with me.

I am a law abiding, taxpaying businessman that has fallen victim to an outdated system. The customer should remit use taxes to the State of Iowa but they never do.

In addition, word of mouth from the do-it-yourself customer many times simply sends the customer directly to the internet to avoid tax. They may come to my store to look at samples but that is it.

Collecting this tax is simple. Just go by the ship-to zip code and remit taxes just like anyone else. No one should be exempt from remitting taxes. There should be no $500,000 exemption.

In addition, the states need this revenue in tough times. Think of the millions of dollars lost year after year by this antiquated law!

We are building a new store at present and have considerable confidence in our customer base but need to level the playing field on issues such as this.

Thank you so much for allowing me to provide this written testimony.

Sincerely,
Mark Jorgensen
Carpet World/Flooring America
Fort Dodge, IA 50501

Mr. KING. Thank you, Mr. Chairman.

This other thought is this, that I am one of those people that believes that I want the IRS out of my life. I want them out of the interference business of free enterprise decisions completely. I don't want to have to look at some corporate structure and see they have a whole floor of tax lawyers up there. I don't want to hear again from my oldest son who owns the second generation now of King Construction tell me the narrative about talking about a business proposal with an individual whose business background complements his very well, for 90 minutes they discussed a business proposal that at the end of that time David King said do you realize our entire discussion about this business venture has been about taxes, the IRS, tax avoidance, and how we are going to incorporate it into our business model? Couldn't we have spent that time a lot better planning business and figuring out how to provide a profit or service or good that has a marketable advantage? And so you will all know then by now that I am for a national sales tax, that I want to eliminate the Federal income tax, and in doing so there is no necessity for the IRS. We can find a way to collect this Internet sales tax without the IRS, and—but here is the problem I have. If we go forward with a tax situation as some of the opponents of this bill have and if we are not able to collect the simplest thing, which is the sales tax on Internet sales, how in the world could we ever, then, have an Internet sales in the world of a national sales tax? And I turn to the Governor to see if he would like to respond to that because you are a State that has a version of the income tax, and I appreciate it.

Governor HASLAM. Right. I mean, that—I won't go into the whole national sales tax debate, but I think that, I mean, if you were there, obviously that would make, that would prove, that would make this argument even more sensitive. So I do think, you know, your basic argument about the retailers who are using the States' money to compete is really what we are talking about.

Mr. KING. I thank you, Governor. I turn to Representative Harper and ask if he would have a comment on the point that I made.

Mr. HARPER. Yeah. I personally am in favor of a consumption or national sales tax and, you know, doing away with the others, but that is just my opinion, not speaking for Streamlined Sales Tax. In some of the versions of the national sales tax it appears, though, that the States would be collecting on behalf of the Federal Government, remitting to the Federal Government. That is just an observation that I have.

Mr. KING. Of course there would be a fee that would go back to the States that would compensate them for their trouble, and we would make sure that that was there.

Mr. HARPER. There would be collection compensation.

Mr. KING. Pardon me?

Mr. HARPER. There would be a collection compensation.

Mr. KING. Yes. That is my plan anyway. I thank all the witnesses. I see the light has turned red, and so I would yield back the balance of my time.

Mr. MARINO. Thank you. The Chair recognizes the gentlewoman from California, Congresswoman Chu, for 5 minutes.

Ms. CHU. Thank you, Mr. Chair. Before I came to Congress I was on the California Board of Equalization, which is the Nation's only elected tax board, and our primary responsibility was, in fact, to collect sales tax. During the years I was on this board I saw a steady decline in sales tax revenue, and today this loss will cost our State $1.9 billion at a time when the State is facing a potential $6.1 billion in cuts in November, most of which would be absorbed by K-12 and higher education. So this is serious business.

And one thing I know is that the current system doesn't work. The current system relies on individual compliance to pay their use tax or for the State entities to do auditing. A very inadequate means to address this. So it is clear that we must pass legislation such as the Marketplace Equity Act, of which I am a cosponsor, so that States can collect all the sales tax they are owed, and I want to commend Chairman Smith for calling today's Judiciary hearing on this bill, but I hope we can work to get this bipartisan bill to the floor before the end of the year.

Let me first talk about the tactic of getting individuals to try to pay their use tax. Some panelists have talked about the burden for small remote sellers of collecting the sales tax for the consumer, but under current law the burden falls on the individual. To ensure compliance, a consumer would have to keep a running list of all the online or catalog purchases they make in an entire year, from a pair of cheap flip flops to diamond earrings. They would have to record the description of the purchase, the price and the date of the purchase. In many situations consumers have to submit an additional form and a separate payment to ensure compliance.

Mr. Kuttner, can you explain in more detail why businesses, even small businesses, are able to do this more efficiently than individuals can?

Mr. KUTTNER. It goes back to what you started off with, which is how——

Mr. MARINO. Sir, is your microphone on? Could you pull it a little bit closer?

Mr. KUTTNER. It is, but my voice isn't on. The current sales tax, your board, your predecessors on it years and years ago could have started off with the idea of not having businesses do it, they could have had the idea of every taxpayer keep track of these things, but that would have been an incredibly inefficient approach, and so that is what the notion of having the businesses doing the collection does. It brings in a degree of efficiency and it makes it easier, and that is why from the little data that we have about, only about in those States which do have an effort to try to put sales tax on their, use tax on their income tax returns, only about 1.1 percent of households are going ahead and doing it. So clearly at the household level it is an incredibly burdensome tax, and so the efficient solution regardless of whether, how you want, what the tax should be, the efficient solution is to get the companies, the sellers which have scale economy to use that scale economy to realize the efficient result.

Ms. CHU. Right. Governor Haslam and Representative Harper, I wanted to talk for a moment about the inefficiencies of auditing, and you may have encountered that. Of course, we call this tax that people owe use tax, but I can attest to the fact that there is

a complete lack of compliance with this use tax obligation by State residents, and even though in our State of California we actually have a line on the income tax form that says that people have a use tax obligation, people still ignore it. Few people even know what a use tax is, and then they are shocked to find out that they even owe it, which leaves auditing as our only alternative. But why is auditing more burdensome both for the State and for the consumer?

Governor HASLAM. I think just the sheer number of individual audits that would have to happen in this case makes it, you know, particularly in a State as large as yours, makes it incredibly difficult. One anecdotal piece of evidence, we did have one of our retailers put on its yearly statements to folks saying you bought this much, you owe this much to the State. Now, there was no, you know, threat of enforcement anywhere, but once people were notified, we actually saw the amount we collected off of that go up like tenfold. But it is still, you know, the ability to audit that for the State would require an incredible amount of work.

Mr. HARPER. And I think, if I may, the Governor is correct. As we have looked at it, you know, there are two ways to go through and collect the use tax, either a business does it or an individual does it, and by having the additional auditors come in, people would feel like they have an auditor sitting at their kitchen table which would be very onerous and irritating. Granted in Utah we only have 1.6 percent compliance with the use tax, we have a line on our income tax return. Most people don't even think about it. But I think some people more and more are thinking about it and are intentionally saying, hey, I can save a little bit because of this government inequality that is on the books.

Ms. CHU. Thank you. I yield back.

Mr. MARINO. Thank you. The Chair now recognizes the gentleman from Arkansas, Congressman Griffin.

Mr. GRIFFIN. Thank you, Mr. Chairman. Thank you all for coming. I appreciate your time. I first want to say that I am—I want to congratulate my colleague from Arkansas, Congressman Womack, Steve Womack, for all the work that he has done on this particular issue.

I have studied this issue quite closely, and I would first like to just mention that if you take a look at the pledge that we have talked about, the gentleman that is leaving has talked about, it clearly is dealing with marginal tax rates, which this does not.

Second of all, I am a pledge signer, and I signed that pledge not because of what Grover Norquist, says but because that indicates in a formal way my position to my constituents, and so I want to just make that very clear.

I also want to talk about something, I support the bill, I am a cosponsor, so I want to say that, and I support it because of fairness. I support it because of the current unfairness, the way that brick and mortar are treated versus Internet businesses. I do not support it because I am worried or feel sorry for governments not collecting more money. That is not why I support it. I support it because I want a level playing field, because I hear from my constituents back home who have businesses like Hank's Fine Furniture in Little Rock and around, and they talk about the different

folks who may come in and shop and then buy elsewhere, and there is an unlevel playing field there. They are very involved in the community. They give to a lot of charities. They have a $4.7 million payroll. I asked them this morning before this hearing to give me some stats. They have 250 employees, and of course they have to hire people to fix their air conditioner and take care of their physical plant. So I support this because of fairness.

One of the things that I never hear discussed hardly at all in this context, though, is what the States are going to do with the money, okay? So I am on the record of supporting this, and a lot of money will go back to the States and others. I think that every Governor in the country, every State representative in the country, every State senator in the country ought to go on record and tell constituents what they are going to do with the money that they are going to get as a result of this.

My personal view is that we should reduce taxes commensurate with the additional revenue that comes in. That is what I believe. Why do I say that? That way you get fairness between the Internet and bricks and mortar, but you are not raising the tax burden. I understand you are not increasing taxes here. These are taxes on the books. But you do have some people who will pay taxes that didn't pay before. And so I think it is fair to say we have ensured fairness with this bill, it is up to the States, but every State rep, State senator and Governor ought to tell us what they will do with that money, and I personally believe they ought to return it to the taxpayer. Then if they think they need additional revenue, they can make the case, they can make the case to people.

That is the way I would like to see it play out. Obviously that is going to be up to the States. That is not something the Federal Government will decide. Some States will say, man, we are enjoying all this extra money, and we are going to spend it this way. Other States are going to say, we are going to have conservative leadership, you know, I have heard that there is a gentleman on this Committee who is going to be Governor of a midwestern State, and I think, I don't want to steal his thunder, but, you know, I think he has indicated that he would like to take the additional revenue and return it by lowering some of the tax rates. So that is going to be up to the States to decide. But with this microphone I am going to preach that my opinion is we need to pass this, we need to have the fairness as a result, but we need to return the extra money to the taxpayers.

Governor HASLAM. Thank you, Congressman, I will take that as a question maybe and——

Mr. GRIFFIN. What do you think?

Governor HASLAM. Right now we are proud in Tennessee.

Mr. GRIFFIN. My time is up but——

Governor HASLAM. We have the second or third lowest combined State and local tax rate in the Nation right now. So, believe me, we are tracking with you.

Mr. GRIFFIN. Yes, sir.

Governor HASLAM. We have cut rates two or three times. Here is the message that I would bring back to Washington, and I know you agree with it. We understand there is going to be less money coming from Washington in the future. I don't know how the budg-

et battle, but somehow it has got to get solved, and as a Republican I am encouraging you to get it solved. We understand there will be less money coming from Washington, and like I said, we will live with that. You have to let us then go through our budget process as well and then judge us by our records. Like I said, we have cut taxes three times since I have been Tennessee's Governor, a year and a half.

Mr. GRIFFIN. Mr. Chairman, may I have 15 more seconds?

Mr. MARINO. Yes.

Mr. GRIFFIN. One thing, I agree with you, and one thing I would add to that is I think we are over the coming decades going to be living in a world where less money will come up here, and that makes more sense. When you have got small town mayors asking, begging for Federal money to build something completely unrelated to anything in the Federal Government, it is because we have taken so much of their money in the first place, and we have created dependency with those mayors and those city councilmen, so they come begging us for money. I would much rather that money stay in the States and we take less of it up here.

Thank you.

Mr. MARINO. The Chair now recognizes the gentleman from Florida, Congressman Deutch.

Mr. DEUTCH. Thank you, Mr. Chairman. Mr. Chairman, my friend from Arkansas suggested what he might like to hear some of the State representatives and State senators and Governors say. I would take this opportunity to point out that I would like to hear every one of my colleagues that I serve with in this body say exactly what Mr. Harper said quite heroically earlier, and that he is and everyone who serves in this body is accountable to the people who elect them and not to Grover Norquist. So thank you, Mr. Harper, for that statement, and I wanted to be on the record with that as well.

Now, let me talk about this legislation, and I would like to broaden the discussion a bit. We talk a lot about fairness, and my colleagues have talked about it, and they are right to do it, but I want to talk about the impact that goes beyond that mom and pop retailer who is at a significant competitive disadvantage today and talk about the other retailers who may not be impacted directly but are impacted very significantly by this unlevel playing field that we have today, and here is how, and I would love to hear from the panelists about this.

We know about, we have heard lots of examples about the individual retailers who have a customer come in, someone they think is going to be a customer, and they ask questions, they take advantage of all that retailer's expertise, then they may leave and buy the product online or they may ask the retailer to match the price. Often the retailer can't, and they will buy it online. But what we don't—what we haven't talked about this entire day is the role that not just that retailer but that that entire Main Street block or that that entire shopping center plays in the community and what happens because of this system is not just because—not just that small retailers can't compete and may have to close but, yes, there are some larger retailers as well that can't compete and have to close, and let's talk about what happens when they do. If that larger re-

tailer closes, the larger retailer that has been blamed so often for all of the ills of these small mom and pops, when that larger retailer closes, all of the employees of that larger retailer lose their job, and that has an impact on the community, and when that larger retailer and the small mom and pop, when they all start to close, there are other businesses on that block or in that shopping center who are also impacted. The nail salons, the barbershops, the restaurants. When you have part of Main Street that goes dark, then suddenly you are not drawing as many consumers. There aren't as many people from the community who are coming to shop there. It is true on Main Street, and for those of us who represent suburban areas, it is true for a shopping center. And when there are lots of vacancies, it is a lot harder for those other service providers who don't pay sales tax often, not in my State, but it is harder for those service providers then to have that flow of customers, people who come to see that they are there when they are out purchasing something in a store, and then they are impacted. And what is the impact then? They lay people off, they shut their doors. And suddenly you are in a situation where half or three-quarters or all of Main Street is dark, not just that mom and pop retailer who couldn't compete as a result of this unlevel playing field. And the same thing is true when the shopping center goes dark. When half of it or three-quarters of it goes dark, there are a lot of people who lose their jobs beyond, as I pointed out, beyond just the individual mom and pop retailer that has been the focus of this hearing. There are a lot of people who lose their jobs, and for people who live in the communities near these shopping centers or for people who live downtown near Main Street, they lose the ability to go out and pick something up in those stores that could no longer survive. They lose the ability to go out and spend time with their community members in those shopping centers, and the community loses corporate citizens who contribute to the baseball teams, who contribute to the Boy Scouts, who contribute to making that community great. There is a lot more at stake here than just the issue of fairness for one particular retailer. There is a community at stake here. And I think that is what we have to realize, that is why I am supportive of these efforts, and I don't know if—I guess I would turn to our local elected officials first to see if they have anything to add to what I have just said.

Governor HASLAM. Amen.

Mr. HARPER. Total agreement.

Mr. DEUTCH. Mr. Chairman, I hope as we have an opportunity to move forward that, yeah, we continue to figure out the best ways to do this and how the technology, and I hope we have another chance to talk about the technology that exists now that actually makes this collection I think easier than it has been suggested at some point earlier today. I hope we can talk about that, I hope we can talk about the broader issues having to do with this legislation, but let's not lose track of what is happening in our communities today because of a playing field that makes it too hard for too many to compete on.

I appreciate it, Mr. Chairman. I yield back.

Mr. MARINO. Thank you. The Chair now recognizes the gentleman from Nevada, Congressman Amodei.

Mr. AMODEI. Thanks, Mr. Chairman. I want to thank, first of all, Ms. Sánchez for being here because usually I am the last guy, and so thanks for taking the anchor for me today. I appreciate that.

Mr. DelBianco, I have listened to most of this stuff and I get that, and I have looked through the testimony, and some of the gentlemen say we think this ought to be origin based, and obviously the gentlemen from the Beehive State and the Volunteer State are in favor of it, that sort of thing. Is it your position that Internet sales should not be taxed, either sales or use or are they tax exempt in your organization's view?

And since I waited a long time, I won't do something like Mr. Griffin did, but please be crisp in your response since you are probably having as much fun as I am at this point.

Mr. DELBIANCO. Thank you, Congressman, and as all of us know, although it has been glossed over today, all Internet sales are taxed exactly the same as brick and mortar sales, every single catalog company, online company in Nevada collects in Nevada, 17 of the top 20 e-retailers already collect for everything they sell in Nevada because they have stores. There has never been and no one has ever asked for some exemption for the Internet. The *Quill* case was written in catalog. Internet sales are all subject to sales tax, and they are today.

Mr. AMODEI. So your answer to my question is yes, they should be taxed?

Mr. DELBIANCO. And they are.

Mr. AMODEI. Okay. So that is yes in my view, and you can say they are, and we won't spend time on that.

Now, having said that, I have listened to your testimony about 10,000 different taxing jurisdictions. With the alternative being, as I believe the gentleman from Utah indicated, it is like, well, we have got a form on our State income tax and we can do that. I don't know how many customers you have, but I am guessing it is a bit north of 10,000 when you talk nationwide, and God forbid we use the word efficiency in anything we should do in a policy sense at this level, but—and I understand 10,000 is a big number, but relying upon even the, you know, number of people that shop online or in catalogs in Nevada to fill that out, although we don't have an income tax, we do have a use tax, it is like, I mean, seriously at some point in time efficiency has got to come into play and where is the best spot for this? You indicated the Texas example with Amazon. It is not that Amazon had to pay the tax, it is that Amazon decided not to charge the tax, and I guess whatever happened in the Lone Star State didn't go their way, so they were liable for it. That is that way everywhere. But when we talk about the dents in the bill because it is not perfect, surely we are not going to rely upon the tens of or hundreds of millions of customers nationwide to file those documents as opposed to using it at point of sale, whether it is at the origin rate or at different rates depending on the jurisdiction?

Mr. DELBIANCO. You are absolutely right, it would be crazy for us to expect individual consumers to start to remit use tax. I think that what will happen is that we need a bill that forces the States to truly simplify the way they set out after the *Quill* ruling, where there is one rate per State for the remote companies, where ven-

dors are compensated for the cost of collection, just like in-State vendors are compensated. One audit for all 46 States, one set of definitions and a small seller exception that protects that small company in your State who is just trying to satisfy customer orders outside of Nevada.

Mr. AMODEI. Okay, and I get that, but then we get back into the fairness stuff that Mr. Deutch, so it is like so if I have to be doing business in Truckee, California, into Nevada I get a $500,000 exemption, but if I am in Reno selling into Nevada I don't. That bothers me a little bit on the general fairness stuff, but—and I appreciate that you have thought about things, saying here is what we recommend. So is your alternative you want an exemption and you want to simplify to one return per State, and then it is okay to do use or sales tax?

Mr. DELBIANCO. If we implemented all the simplifications in here, and they are very similar to what Mr. Henchman has articulated, with those in place we then turn to a small seller exception, and the small seller exception can't be anything as low as a million dollars. As I explained earlier, that is a one- or two-person company at most, and you talk about fairness, is it fair for that one- or two-person Nevada company shipping their specialty items around the country to collect for all those jurisdictions? It isn't. The small seller exception needs to be high enough and yet still allow the States to collect 90 percent of what they claim they are not getting, and a level of $15 million in sales gets them 90 percent.

Mr. AMODEI. Are you aware of anywhere in the Nation where there is a small seller exemption under State law right now?

Mr. DELBIANCO. Under Federal law, the Small Business Administration says a retailer is small when they are under $20 million. This Congress has passed——

Mr. AMODEI. No, the question is, the question is, is there an existing exemption in State law anywhere that you are aware of that says if your sales are below X amount a year, you don't have to collect State sales or use tax?

Mr. DELBIANCO. Of course not, and every online seller already collects.

Mr. AMODEI. Why would we do it now?

Mr. DELBIANCO. There's no small seller exception.

Mr. AMODEI. So why would we create one in this context?

Mr. DELBIANCO. The Federal Government has plenty of small seller exceptions, recognizing the burdens in *Quill*. You should probably enact a similar small seller exception. The States can't do this on their own, they need Congress to force businesses to comply, and Congress ordinarily, like the bill you just passed this year on the small business tax cut, said that a small business was under 500 employees. That may not be appropriate for retail, but you need a small seller exception.

Mr. AMODEI. You have exhausted my time, and thank you for doing so, and thank you for your responses.

Mr. MARINO. Thank you. The Chair now recognizes the gentleman from Colorado, Congressman Polis.

Mr. POLIS. Thank you, Mr. Chair. I would also like to engage with Mr. DelBianco. I want to understand taking away sort of breaking out how many small businesses work, sales and margins.

What would a typical, if there is a small company, it could be a vintner, it could be anything, and their sales are a million, two million. What would be typical of the margins, you know, how much more they are selling a good for than what they purchase it for for a small business like that?

Mr. DELBIANCO. Thank you for the question. We look at gross margins, which is the cost of sales as a percentage of the retail price.

Mr. POLIS. And what do you find?

Mr. DELBIANCO. And they range anywhere from 30 percent down to as low as 20 percent in the data that I looked at. So I used 25 percent for the example I articulated earlier today, that a million dollar seller right away loses $750,000 for cost of sales, and then has to cover all those other expenses from marketing, distribution, web site, accounting, computer programming.

Mr. POLIS. And your estimates further show that the cost of collection, I believe this was from the Streamlined Sales Tax estimates, that it would cost about 17 cents for every tax dollar it collects for the States?

Mr. DELBIANCO. That is the data that Streamlined Sales Tax collected.

Mr. POLIS. So again that would effectively in many cases wipe out the margin for a hypothetical million dollar business. Coupled with the gross margin and the cost of compliance and all their other costs, it might have been a business that previously had a small profit, but after this additional burden it would cause it to go into the red. Is that possible?

Mr. DELBIANCO. Yeah, absolutely.

Mr. POLIS. And I think the concern there is that in that situation where you have a business that can no longer exist profitably, they are not going to exist. Therefore, they are not going to pay any taxes to the government. It is a very hypothetical tax when you are talking about imposing it on businesses at the $500,000 or million dollar in gross sales level where in many cases these taxes would be a deterrent to even having that sort of business. They would be very difficult, the under $150,000 which is being talked about, and then once you are several million, you know, whether, you know, five, 10, 20, whatever it is you might be able to absorb some compliance costs, but there is very little margin to spare for many of these businesses in that middle realm that we hope that job growth emerges from. These are not, you know, in many cases terribly profitable businesses. As you mentioned, they might be purchasing something for $7.50 and selling it for $10, some of them are even less than that. In fact, the more competition we have in the marketplace, and the Internet obviously encourages and makes it easier, reduces barriers to competition, the more squeeze on the margins there will be in general, and that is obviously a good thing for consumers, and the more efficiently retailers are able to turn around products and operate, consumers will benefit from that.

Now, again, the flip side is that this is both a compliance cost and a tax on the gross sales, not on the margin. So when you have a particularly low margin product, you are effectively taxing the gross sales, which will make it very difficult to profitably sell low margin products, which are equally as important to the economy as

high margin products. Therefore that makes, you know, again some of the estimates of the taxes that would be collected hypothetical in the sense that many businesses that they would be collected from would actually be driven out of business or uneconomical by having to both comply with and pay these taxes which would otherwise obliterate any margin that they have.

I was also wondering, Mr. DelBianco, if you could address briefly now, mail order has existed for, you know, certainly as long as I have been alive, Sears catalog, all those days. This has always existed, and we have had the issue of doing the nexus, and why is this any different today other than is it any different than just basically having more volume going through mail order channels which, by the way, was the case in the Sears catalog height days. It probably—you know, that was a big deal on where you could get things. Is there really any difference in the landscape or is it just an order sort of the volume coming through these channels?

Mr. DELBIANCO. You are absolutely correct, it is just the volume. The *Quill* ruling was with respect to a catalog company and had to do with remote burdens on businesses to have to collect and remit taxes for places where they had no physical presence at all.

Mr. POLIS. And, you know, many of these e-commerce companies as they grow actually establish nexuses in many different States for logistical reasons, for business reasons. As they do so, they of course fully contribute to those States as well, sort of one of the natural cycles of growing. That is why many of the large e-commerce companies operate and pay taxes in a number of States that they operate in as well.

So I think as we look at small business, to a lot of people a million dollars a year sounds like a lot of business, a lot of money. It is important to point out this is not somebody who is going to the bank with a million dollars a year. They may be earning $50,000 a year, they may be earning $75,000 a year, their earnings may be wiped out entirely if they have to hire accountants and implement software and take their time away from selling their product to manage the compliance of this until they get to a size where truly they can absorb any of those additional costs, and I yield back.

Mr. MARINO. Thank you, Mr. Polis, and I might add the only ballplayer this season when we played the congressional baseball game to get an inside-the-park home run.

Mr. POLIS. Which I thank the Chair for the credit. It was officially scored as a double and a two-base error, but I will take the home run.

Mr. MARINO. It was still a run, so we will chalk it up to that.

The Chair now recognizes the woman from California and, I might add also, the only woman to be drafted in the congressional baseball team this year, Congresswoman Sánchez.

Ms. SÁNCHEZ. Thank you, Mr. Chairman. And thank all the gentlemen on the panel for being so patient, and I was not here for much of the hearing, so I apologize if I will cover territory that has already been covered. But I am a big fan of H.R. 3179, the "Marketplace Equity Act of 2011," and I think it is a great bill, and I applaud the Committee for discussing it today. I probably don't need to remind my colleagues from California and probably anybody else here about the need for State governments to receive the

entirety of taxes that are due to them. The State of California, which is undergoing tremendous budget shortfalls, is expected to lose nearly $1.8 billion in uncollected revenue alone, and that would go a large way toward helping us with our budget woes. You know, and not trying to place blame because many consumers just aren't aware of their responsibility to pay their use tax from online payments. And furthermore because remote sellers aren't required to collect sales tax, it puts them, as many of the witnesses noted in their written testimony, at a distinct advantage to the brick and mortar businesses that exist in all of our districts and that we want to see survive and thrive.

The Internet undoubtedly has changed many sections of our economy, particularly how we treat remote sellers. It is my humble opinion that we no longer live in an era when the complications that the Supreme Court acknowledged in the *Quill* decision continue to be an obstacle to the collection and the remission of sales tax by remote sellers. At a time when many local governments and States are struggling and many people are out of work and looking for work, I think that H.R. 3179 is a common sense solution that helps level the playing field for retailers and provides States with the tax dollars they deserve and also allows States the flexibility to address taxation in a way that best fits their unique situation.

So I have given my opinion, but I would like to just touch on a couple of questions, and I would like to start with Governor Haslam.

Your State, I understand, is not a full member of the Streamlined Sales Tax Agreement; is that correct?

Governor HASLAM. Currently, right.

Ms. SÁNCHEZ. Okay, and neither is my home State of California. Can you reiterate in your opinion why we need the national solution outlined in the Marketplace Fairness Act?

Governor HASLAM. Well, I think without it the *Quill* decision stays in effect, and *Quill* specifically said it was up to Congress to change the thing, Congress had the ability to do that.

Ms. SÁNCHEZ. Great. And you noted in your testimony that you don't believe in increasing taxes, so when your constituents in Tennessee ask you about the collection of online sales tax, how do you explain it to them in a way that reassures them that it is, in fact, not a new tax?

Governor HASLAM. Well, not always easy, but I think the reality is what I firmly believe, it is a tax that is currently due and not collected, and so we have a situation where we are enabling a lot of people out there to break the law.

Ms. SÁNCHEZ. Thank you. Representative Harper, as many witnesses and Members of the Committee have acknowledged today, consumers just aren't paying the use tax. Do you think that that system is fair to consumers?

Mr. HARPER. Which system, the one in this bill?

Ms. SÁNCHEZ. No, the status quo right now that many people aren't paying the use tax.

Mr. HARPER. I think it advantages wise consumers who go out there and specifically try to avoid paying a sales tax based on the government inequity that is on the books, and I think it disadvan-

tages local businesses who are required to pay a—to collect a sales tax and not those who are remote.

Ms. SÁNCHEZ. Would it also disadvantage consumers that perhaps aren't technologically sophisticated or don't even have a computer or access to the Internet in their home?

Mr. HARPER. Yeah, it creates an unlevel playing field.

Ms. SÁNCHEZ. Thank you. You also spoke in your testimony to a point that technology currently exists to collect sales tax; is that correct?

Mr. HARPER. Yes.

Ms. SÁNCHEZ. And you noted that eight companies currently have the technology to collect that tax. Do you have a sense of what it costs to have that technology in order to do that?

Mr. HARPER. It depends on the size of the company and how you handle it. I have met with a number of small businesses who say it is very simple, cheap, they can afford it, they have, you know, just a single product that they sell online, they use it. I am concerned with statements that have been made that, you know, the cost of collection or the collection of the tax would be an undue burden on business and would drive them out of business. What we are promulgating is the fact that there will be a vendor—there can be a vendor compensation, and it will not increase the cost on a business.

Ms. SÁNCHEZ. Would it be accurate to make the assumption that if the burden of collecting sales tax was placed on the remote seller, companies would look into developing that kind of technology and that the price for remote sellers would be lowered eventually?

Mr. HARPER. Absolutely.

Ms. SÁNCHEZ. Great. Those are the points that I was interested in hearing testimony on. I thank you for your answers, and I yield back.

Mr. MARINO. Thank you. Seeing no additional colleagues for questioning, and in the interest of our guests in the gallery and our distinguished panel, I will not tax you with any questions, and I would like to thank our witnesses for their testimony today.

Without objection, all Members will have 5 legislative days to submit additional written questions for the witnesses or additional materials for the record. This hearing is adjourned. Thank you.

[Whereupon, at 12:52 p.m., the Committee was adjourned.]

APPENDIX

Material Submitted for the Hearing Record

Questions for the Record submitted by the Honorable Jason Chaffetz, a Representative in Congress from the State of Utah, and the Honorable Melvin L. Watt, a Representative in Congress from the State of North Carolina

United States House of Representatives
Committee on the Judiciary
Hearing on H.R. 3179, the "Marketplace Equity Act of 2011"
July 24, 2012
Questions for the Record
(Panel Two)

Questions from Representative Jason Chaffetz

1. Online retailer Overstock.com [1]has told me and many others in Congress that it will support federal legislation to address the remote seller sales tax collection issue *if* the legislation addresses certain basic principles. Those principles are:

   a) States must provide certified plug-and-play software to remote sellers;

   b) Remote sellers have immunity from state and third party plaintiff liability for errors in the software and/or information provided by the state;

   c) States provide remote sellers fair compensation for the installation, integration, operation and maintenance of the software in remote sellers' infrastructure and the collection administration costs;

   d) The be a single state audit in each state, including a single agent contact to address remote seller tax collection issues;

   e) States make meaningful simplification of state sales tax rules;

   f) The legislation include clear language that the collection of sales tax by a remote seller does not, of itself, create nexus in that state for any other taxing or regulatory purpose; and

   g) There be federal court jurisdiction to determine if states are abiding by the law Congress passes.

2. It seems to me that the states are asking that Congress solve their tax collection problem. Many say that plug-and-play remote seller sales tax software exists. While I agree that software exists, I question whether it is as simple for a remote retailer to implement as many proponents claim based on Overstock.com's[2] actual experience in late 2010. Overstock.com[3] selected a software package to enable it to collect sales tax in *one* additional state. It took 20-30 of the company's IT professional staff nearly six months and more than 9,400 man hours to integrate the software into the company's IT system and map the million products the

[1] *See* http://www.overstock.com/
[2] *See* http://www.overstock.com/
[3] *See* http://www.overstock.com/

company sells. The company calculated that the total cost of just the start-up phase was nearly $1.3 million for this ONE state, including the first year software license fee, employee and contractor time, and use of existing IT hardware dedicated to the collection of the tax in the new state. While there would be some economies of scale expanding to 50 states and the 9,600 taxing jurisdictions throughout the country, would you agree that the cost for a remote seller to become the sales tax collector for all or some portion of the 50 states is very high and that the states should fairly compensate remote sellers for these costs?

Questions from Representative Melvin L. Watt

1. If services exist or are developed that sufficiently simplify the tax collection process for vendors, is or will a small business exemption be necessary?

2. Proponents of H.R. 3179 argue that a $1 million small business exemption threshold would exclude more than 90 percent of online retailers thus denying States of much of the uncollected sales and use tax revenue that the bill is designed to help them secure. Opponents of H.R. 3179 advocate for a higher small business exemption threshold ($10 - $15 million) because they argue that a lower threshold would cripple small businesses and, because the top 10 percent of online retailers are responsible for the majority of uncollected sales and use tax revenue, a higher threshold would still capture the majority of uncollected sales and use tax revenue that the bill is designed to help States secure. What is the appropriate small business exemption threshold? Why?

Response to Questions for the Record from the Honorable Bill Haslam, Governor of Tennessee

Responses to Questions submitted for the Record by the Honorable Bill Haslam, Governor of Tennessee:

Questions from Representative Jason Chaffetz:

Answer: The availability of software to help remote sellers calculate and collect sales taxes is an important element of the Marketplace Equity Act. Several vendors are currently marketing software solutions for all sizes of business to allow sellers to collect and remit sales taxes, many at costs far below the example you sited for Overstock.com. While I cannot speak to details of Overstock.com's experience, retailers in Tennessee stress the importance of leveling the playing field between online and Main Street retailers. While they are aware that software will be necessary to comply with the law, their focus has been on creating equity in the marketplace so they can compete on equal footing.

Questions from Representative Melvin Watt:

1. Answer: Services that simplify the collection process for vendors will make it significantly easier for vendors of all sizes to collect and remit sales taxes. It may also decrease the arguments in favor of a small business exception. That being said, NGA has long supported a small business exception as an important component of federal legislation.
2. NGA has long supported a small business exception as part of federal legislation to provide states the authority to require remote vendors to collect and remit state and local sales taxes. The level of such an exception should be determined by Congress, and should be set at a level sufficient to protect truly small sellers without undermining the intent of the bill to authorize the collection of sales taxes on all applicable sales.

Response to Questions for the Record from the Honorable Wayne Harper, Utah House of Representatives

Chairman Lamar Smith
Committee on the Judiciary

September 15, 2012

Thank you for the opportunity to address the Judiciary Committee on HR 3179, the Marketplace Equity Act of 2011.

Attached are my responses to the addition questions.

From Representative Jason Chaffetz, Utah

Overstock.com faced some unusual expenses and challenges in implementing their software for the collection of sales tax. That company used a product that was not specifically designed for them, then used internal resources to make it fit their needs.

The intent of Streamlined Sales Tax Governing Board and a number of private companies is to create parameters that are simple, uniform and easy to use. The private companies are intending to offer software that is uniform and close to plug and play. However, with distinct profiles and needs and existing software, at this point no one company has the solution for every situation. SSTGB goal is to create a situation where every company has to file with a single tax authority in each state and is subject to only one audit in each state. That, in and of itself, is a huge saving to the business community.

Likewise as more sates and companies accept uniformity and start remote collection, additional companies, far more than the 8 currently available to collect remote sales tax or offer remote collection software, will open up and enter into the market.

SSTGB's current position is that a small sell exemption is appropriate and that amount is $500,000. My personal view is that the small seller exemption should be phased out over a few years to truly end the government sanctioned advantage non-nexus retailers have over local retailers via the non-collection of due sales tax.

From Representative Melvin L. Watt

Yes. My personal view is that the small seller exemption should be eliminated within a 3 to 5 year period. When Congress passes this or the Senate version of the bill, many new software companies will open up and the cost to collect and remit will become very inexpensive and easy.

Streamlined Sales Tax believes that a $500,000 small seller exemption is appropriate.

Wayne Harper
Utah House of Representatives
District 43
State of Utah
President Elect, Streamlined Sales Tax Governing Board.

Response to Questions for the Record from Hanns Kuttner, Visiting Fellow, Hudson Institute

Responses to Questions submitted for the Record by
Mr. Hanns Kuttner

QUESTION FROM REP. JASON CHAFFETZ

Question: While there would be some economies of scale expanding to 50 states and the 9,600 taxing jurisdictions throughout the country, would you agree that the cost for a remote seller to become the sales tax collector for all or some portion of the 50 states is very high and that the states should fairly compensate remote sellers for these costs?

Answer: Sellers provide a valuable service to state and local government when they collect the sales tax. Some states recognize this fact and pay retailers through what are called "vendor discounts." As of January 1, 2012, 26 states allowed vendor discounts and 20 states did not, according to the Federation of Tax Administrators (http://www.taxadmin.org/fta/rate/vendors.pdf.) New York provides the largest vendor discount, 3.5 percent of the state sales tax collected, although Alabama allows 5 percent on the first $100 collected. Among the states not offering vendor discounts, California is the largest.

The best evidence about whether the vendor discounts are enough to cover the cost of collection comes from the Joint Cost of Collection Study (JCCS), available at http://www.bacssuta.org/Cost%20of%20Collection%20Study%20-%20SSTP.pdf. JCCS was a public-private partnership that included the Council on State Taxation, the Federation of Tax Administrators, and the National Retail Federation. The JCCS fielded a survey in 2004 and 2005. It is only study which is national in scope. The sample included both single state and multi-state retailers and store and non-store (i.e., remote) sellers. The survey asked about such costs as training personnel on the sales tax, documenting exempt sales, programming and servicing cash registers, filing returns, and handling audits and appeals.

The most striking finding from the JCCS may be the relationship between a seller's size, measured by the dollar volume of its sales, and the cost of collecting the sales tax. For sellers with annual sales of between $150,000 and $1,000,000, the cost of collecting the sales tax equaled 13.47 percent of the tax collected; for sellers with annual sales in excess of $10 million, costs were 2.17 percent of the tax collected. Across retailers of all sizes, costs averaged 3.09 percent of the sales tax collected (representing .19 percent of the sales amount.) With few exceptions, states do not recognize that smaller sellers have higher costs, and those exceptions do not reflect the full variation in the cost of collecting the sales tax across different sizes of retailers, a six-fold difference between small and larger sellers.

One way of thinking about this data is to conclude that many states choose to be neutral between sellers, preferring a level playing field to one that recognizes that smaller sellers face higher costs per dollar of sales tax collected.

Whatever level vendor discounts should be to cover the cost of sales tax collection, the 20 states which do not offer any compensation for collecting the sales tax are below it. (The lag time between when sellers collect the tax from purchasers and the seller remits the tax to the state

creates a no cost source of funds ("float") for sellers. While this once had value, at current interest rates it is a very small compensation in the 20 "no vendor discount" states.)

QUESTIONS FROM REP. MELVIN L. WATT

1. If services exist or are developed that sufficiently simplify the tax collection process for vendors, is or will a small business exemption be necessary?

Answer: The costs that sellers face for collecting the sales tax vary according to seller size. In the best study of these costs, the Joint Cost of Collection Study (JCCS)(available at http://www.bacssuta.org/Cost%20of%20Collection%20Study%20-%20SSTP.pdf) found that the cost of collecting the sales tax decreased by .53 percent as seller size increased by 1 percent. Comparing sellers with sales less than $1 million (in 2005) to those with sales over $10 million found a six-fold difference in the cost of complying with the sales tax.

I would suggest that a small business exemption involves a trade-off between simplicity and fairness. Fairness would focus on the amount states pay sellers to collect the sales tax on their behalf. States make these payments in the form of "vendor discounts," an allowance calculated when a seller remits sales tax to the state. Not all states do this; 26 states do and 20 do not. A fair vendor discount would vary with the size of the seller. A seller with relatively low sales would receive a larger vendor discount than a larger seller. The fairest approach would use data from a study like JCCS and set the vendor discount on a sliding scale. A series of brackets would be simplest (annual sales less than $100,000, $100,000 to $500,000, etc.)

The beauty of this approach is that there would be no need to draw a single line for a small business exemption. However, it is not helpful to legislators at the national level grappling with this issue because vendor discounts are set in state sales tax laws.

Thus we are back to the trade-off between simplicity and fairness, and the fact that the tool most easily available at the federal level is setting an amount that exempts sellers with sales below some threshold. An exemption level is a simpler approach.

One suggestion I would make for line drawing is to draw a line that declines over time. This would recognize that the cost of collecting the sales tax in multiple states will likely decline over time. Better and cheaper information technology will make this happen. It also recognizes that the burden is larger for smaller firms and gives progressively smaller firms more time to develop or acquire the systems they will need. (Given that some of the cost is associated with computer systems changes, having more time makes it likely that the systems changes could be accomplished as part of a larger, periodic overhaul, further reducing the sales-tax-specific systems cost. Computer systems costs will likely be lower if they are part of the original design. Setting an exemption over time would put new entrants on notice that this is something they will face if and when they grow, making it more likely that more new entrants have systems that do not require re-engineering to do sales tax calculations for multiple states.) This could be done directly, by setting an initial high threshold in statute and in statute setting a path for the

threshold to decline over time. It could also be done indirectly by setting a statute expressed in nominal dollars whose real value would decline over time by the rate of inflation.

2. Proponents of H.R. 3179 argue that a $1 million small business exemption threshold would exclude more than 90 percent of online retailers thus denying States of much of the uncollected sales and use tax revenue that the bill is designed to help them secure. Opponents of H.R. 3179 advocate for a higher small business exemption threshold ($10-$15 million) because they argue that a lower threshold would cripple small businesses and, because the top 10 percent of online retailers are responsible for the majority of uncollected sales and use tax revenue, a higher threshold would still capture the majority of uncollected sales and use tax revenue that the bill is designed to help States secure. What is the appropriate small business exemption threshold? Why?

Answer: Government should be neutral between in the marketplace, allowing buyers and sellers to arrive at the most efficient pairing up of buyers and sellers. A free and fair market will achieve that efficient combination. A free and fair market requires treating all sellers the same, regardless of size or physical location. From these first principles one can infer that the best solution would be no preference for firms above or below some threshold, nor different treatment of firms that are within a state versus those outside the state.

A size-related exemption is a way to recognize that the fixed costs of sales tax administration mean that the cost, measured as a percent of sales, is larger for smaller firms than larger firms. A small business exemption draws a single line. Firms below the size have no costs; firms above the line have all the costs. The firms that will be worst off are those with sales just above the line, unable to benefit from the exemption for smaller firms but without the scale economies that benefit much larger firms. This will be true no matter where a line is drawn.

I would suggest that the best approach is not to set an exemption level that holds for all time but one that declines over time. This would be a way of balancing equity and fairness, beginning with a higher threshold and then becoming lower over time. A nominal dollar amount written in statute will realize this result as inflation reduces the real value of the exemption.

There is no evidence that shows one approach is surely better than another. To take two dollar amounts mentioned in your question, one could start with an exemption that began with sales at $10 to $15 million that declined over time, say over the course of a decade, to $1 million or less.

Response to Questions for the Record from Joseph Henchman, Vice President, Legal & State Projects, Vice President, Operations, Tax Foundation

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Responses to
Questions from Representative Jason Chaffetz
on the Marketplace Equity Act of 2011

Joseph Henchman,
Vice President, Legal & State Projects, Tax Foundation

1. Online retailer Overstock.com has told me and many others in Congress that it will support federal legislation to address the remote seller sales tax collection issue if the legislation addresses certain basic principles. Those principles are: (a) States must provide certified plug-and-play software to remote sellers; (b) Remote sellers have immunity from state and third party plaintiff liability for errors in the software and/or information provided by the seller; (c) States provide remote sellers fair compensation for the installation, integration, operation and maintenance of the software in remote sellers' infrastructure and the collection administration costs; (d) The[re] be a single state audit in each state, including a single agent contact to address remote seller tax collection issues; (e) States make meaningful simplification of sales tax rules; (f) The legislation include clear language that the collection of sales tax by a remote seller, does not, of itself, create nexus in that state for any other taxing or regulatory purpose; and (g) There be federal court jurisdiction to determine if states are abiding by the law Congress passes.

The process of sales tax collection is presently complex and fragmented. Key contributors to this are (1) a general determination by many jurisdictions to duplicate reporting, collecting, and auditing functions; (2) poor guidance on line-drawing between taxable and non-taxable items in advisory rulings; (3) states that permit jurisdictions to define their own tax base independently of the states; (4) far too many overlapping sales tax jurisdictions, which actually grow in number each year; and (5) states' eagerness to grant exclusions, exemptions, and preferential rates to special interests. The entire system is ad hoc and the costs are imposed entirely on retailers that collect the tax.

States' ability to export this mess to out-of-state companies has been limited by the Commerce Clause. To the extent Congress wishes to remove this constraint on state power to collect sales tax from out-of-state companies, some meaningful limitation on state tax power should be substituted. The best approach, in my opinion, is authorize states to collect tax *on condition that they adopt* meaningful minimum simplifications of the kind I explained in my testimony and some of which appear in the list you cite.

Above all, remember that each simplification not adopted is an additional cost that will be borne by interstate commerce. Require a lot of simplifications, and the costs are greatly minimized and you may not even need a minimum threshold. Require few simplifications and the costs are maximized, and state threats to interstate commerce will be great.

2. It seems to me that states are asking that Congress solve their tax collection problem. Many say that plug-and-play remote seller sales tax software exists. While I agree that software exists,

I question whether it is as simple for a remote retailer to implement as many proponents claim based on Overstock.com's actual experience in late 2010. Overstock.com selected a software package to enable it to collect sales tax in one additional state. It took 20-30 of the company's IT professional staff and nearly six months and more than 9,400 man hours to integrate the software into the company's IT system and map the million products the company sells. The company calculated that the total cost of just the start-up phase was nearly $1.3 million for this ONE state, including the first year software license fee, employee and contractor time, and the use of existing IT hardware dedicated to the collection of the tax in the new state. While there would be some economies of scale in expanding to 50 states and the 9,600 taxing jurisdictions throughout the country, would you agree that the cost for a remote seller to become the sales tax collector for all or some portion of the 50 states is very high and that states should fairly compensate remote sellers for these costs?

I agree that collection and compliance costs are high and that this fact is not appreciated by those who do not work with state sales taxes (as I do). Rather than figuring out how to pay for an unnecessarily complicated and economically wasteful enterprise, my position is that a better avenue would be to require simplification of sales tax systems as a condition of states gaining the power to collect from out-of-state vendors. No more vague definitions. No more having hundreds of different jurisdictions in your state. No more taxing food seven different ways. No more having everyone do forms and audits and payments differently from everyone else.

If we can do that, the waste of time and resources that goes into all that nonsense can be redirected into more productive avenues, without reducing the revenue that states and localities get. As the SSTP experience shows, only Congress will be able to get that set as a standard, either by enacting simplification requirements or credibly threatening to enact simplification requirements.

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Responses to Questions from Representative Melvin Watt on the Marketplace Equity Act of 2011

Joseph Henchman,
Vice President, Legal & State Projects, Tax Foundation

1. If services exist or are developed that sufficiently simplify the tax collections process for vendors, is or will a small business exemption be necessary?

Technology AND state sales tax simplification is necessary to make the process easy enough to obviate the need for a small business exemption. Look-up software is crucial, but so is addressing (1) a general determination by many jurisdictions to duplicate reporting, collecting, and auditing functions; (2) poor guidance on line-drawing between taxable and non-taxable items in advisory rulings; (3) states that permit jurisdictions to define their own tax base independently of the states; (4) far too many overlapping sales tax jurisdictions, which actually grow in number each year; and (5) states' eagerness to grant exclusions, exemptions, and preferential rates to special interests. The entire system is ad hoc and the costs are imposed entirely on retailers that collect the tax. Awesome software solves none of those problems and is even limited in its ability to navigate those problems.

2. Proponents of H.R. 3179 argue that a $1 million small business exemption threshold would exclude more than 90 percent of online retailers thus denying States much of the uncollected sales and use tax revenue that the bill is designed to help them secure. Opponents of H.R. 3179 advocate for a small business exemption threshold ($10-$15 million) because they argue that a lower threshold would cripple small businesses and, because the top 10 percent of online retailers are responsible for the majority of uncollected sales and use tax revenue, a higher threshold would still capture the majority of uncollected sales and use tax revenue that the bill is designed to help States secure. What is the appropriate small business exemption threshold? Why?

A large threshold would collect most of the uncollected revenue while concentrating compliance costs on large firms, at least if the current state of the industry remains mostly unchanged. A small threshold wouldn't raise much more money but would increase compliance costs.

That said, rather than figuring out how many firms we should subject to an unnecessarily complicated and economically wasteful enterprise, my position is that a better avenue would be to require simplification of sales tax systems as a condition of states gaining the power to collect from out-of-state vendors. If we can do that, the waste of time and resources that goes into all that nonsense can be redirected into more productive avenues, without reducing the revenue that states and localities get. As the SSTP experience shows, only Congress will be able to get that set as a standard, either by enacting simplification requirements or credibly threatening to enact simplification requirements.

Response to Questions for the Record from Steve DelBianco, Executive Director, NetChoice

United States House of Representatives
Committee on the Judiciary
Hearing on HR 3179, the "Marketplace Equity Act of 2011"
July 24, 2012
Questions For The Record
(Panel Two)

Questions from Representative Jason Chaffetz:

Question 1. Online retailer Overstock.com has told me and many others in Congress that it will support federal legislation to address the remote seller sales tax collection issue if the legislation addresses certain basic principles. Those principles are:

a) States must provide certified plug-and-play software to remote sellers;

b) Remote sellers have immunity from state and third-party plaintiff liability for errors in the software and/or information provided by the state;

c) States provide remote sellers fair compensation for the installation, integration, operation, and maintenance of the software in remote sellers' infrastructure and collection administration costs;

d) There be a single state audit in each state, including a singe agent contact to address remote seller tax collection issues;

e) States make meaningful simplification of state tax rules;

f) The legislation include clear language that the collection of sales tax by a remote seller does not, of itself, create nexus in that state for any other taxing or regulatory purpose; and

g) There be federal court jurisdiction to determine if states are abiding by the law Congress passes.

Answer from Steve DelBianco:

Overstock is a member of NetChoice and we fully support all of the principles Overstock has stated.

Moreover, all of Overstock's principles are embraced by True Simplification of Taxation (TruST), a coalition that includes NetChoice, the American Catalog Mailers Association, the Direct Marketing Association, and the Electronic Retailing Association.

However, TruST takes a broader view than Overstock, and calls for additional simplifications that are essential for catalog companies and retailers of all sizes who use the Internet. The 12 TruST simplifications are listed below, indicating how each relates to Overstock's basic principles.

Twelve Key Simplification Provisions For Federal Legislation on Remote Sales Tax Collection

1. States must provide certified software for rate lookup, collection, electronic filing, and funds transfer. Users of the software would be immune from state and civil liability for errors in taxes collected. (Overstock items a and b)
2. A single sales tax rate per state for remote sales. (Required for customers who use mail-order catalogs and send checks with their orders)
3. States should compensate businesses for reasonable costs of collecting sales taxes, including purchase and implementation of software. (Overstock item c)
4. A single set of definitions for taxable and exempt products for all states. (Overstock item e)

5. A single audit on behalf of all states and local jurisdictions conducted by a single state where the seller has physical nexus, or a designated state in cases where a seller lacks physical nexus in any sales tax state. (Overstock item d, applied to a single nationwide audit)
6. There should be a common sales tax return for remote sellers to file. (Remote retailers should not be forced to file 46 separate state tax returns each month)
7. A single national rule for sourcing sales. (Overstock item e)
8. Harmonize sales tax holidays and thresholds, or give remote sellers an optional exemption from participation in sales tax holidays and thresholds. (Overstock item e)
9. Allow remote sellers to challenge states in federal district court for disputes on sales tax collection, including whether a state is following congressionally required simplifications. (Overstock item g)
10. Preempt and preclude state laws imposing sales tax obligations on businesses with no physical presence in that state. (Once Congress creates this path to tax collection, the states must follow this one path, and stop trying to stretch the definition of nexus beyond physical presence)
11. Collection of sales tax under federal legislation does not create nexus for any other business purpose. (Overstock item f)
12. A congressionally determined exception for small businesses. (Retailers that are much smaller than Overstock must be protected from impossible new burdens of tax administration for up to 46 states)

TruST believes that *all* of the 12 Principles are necessary for Congress to require true simplification and hold states accountable to the new standards. TruST members have met with several Congressional offices and would be willing to discuss these principles at any time.

Question 2. While there would be some economies of scale expanding to 50 states and the 9,600 taxing jurisdictions throughout the country, would you agree that the cost for a remote seller to become the tax collector for all or some portion of the 50 states is very high and that the states should fairly compensate remote sellers for these costs?

Answer from Steve DelBianco:

Yes, I agree that retailers face high costs to collect for up to 46 states, and that states should fairly compensate retailers for acting as their tax collectors.

Retailers making sales to remote customers incur higher tax collection costs than retailers serving customers at a single location.

Today, under the *Quill* physical presence rule, all online and offline businesses play by exactly the same rule: all retailers collect sales tax for every state where they choose to have a physical presence.

A retail store on Main Street collects sales tax for just the one jurisdiction where it's located. But in most states, an online retailer operating right upstairs is currently required to collect and remit for each of the local towns and counties when it ships within the state. That means collecting for hundreds of local tax jurisdictions, each with its own rates and rules. Yet when customers from surrounding towns walk in the door, the store collects and files *only for its local jurisdiction*.

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

Paying sales tax for thousands of jurisdictions in 46 states is far more expensive and complex than paying sales tax for a single jurisdiction on over-the-counter purchases. Moreover, state and local governments often provide incentives and benefits to in-state retailers, such as tax increment financing, transportation improvements, worker training subsidies, grants, tax credits, property and income tax incentives, etc. None of these benefits are available to out-of-state businesses.

Empirical study shows that small businesses spend 17 cents for every tax dollar they collect.

What costs would a small business face if Congress forced them to pay sales tax to all 46 states? The Streamlined Sales Tax Project's (SSTP) own Cost of Collection[1] study found that a small business (under $1M in annual sales) spends 17 cents for every tax dollar it collects for the one or few states where it must already pay sales tax, as shown in the table below:

Annual retail sales	$150K - $1M	$1M - $10M
Retailer's total cost per dollar of tax collected	16.8	4.2
Training of personnel	1.9	0.6
Documenting tax-exempt sales	3.8	0.9
Customer service relating to sales tax issues	0.7	0.2
Sales tax related software	1.9	0.4
Programming and servicing cash registers	1.2	0.4
Returns, remittances, refunds, sales tax research	5.4	1.2
Sales tax audits and appeals	1.0	0.5
Other compliance costs	1.0	0.2

You may be thinking that legislation before Congress would require states to provide software that makes it free and easy for retailers to collect taxes. But even if "free" tax software were available, it would only help to reduce one element of costs documented above -- "Sales tax related software". At most, free software could therefore relieve only 2 cents of the 17 cents in costs that retailers incur for every tax dollar collected.

That leaves small businesses with a 15% cost burden on every dollar they collect, for things such as:

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

[1] *Available at* http://www.netchoice.org/wp-content/uploads/cost-of-collection-study-sstp.pdf

- Handling audit questions from 46 states
- Paying sales staff, accountants and computer consultants to answer all these questions

These collection burdens will be a big problem for small businesses that collect only their home-state sales tax today. Ask any of your small businesses, on main street or online, and you'll learn how hard it would be for them to begin collecting sales tax for all 46 states.

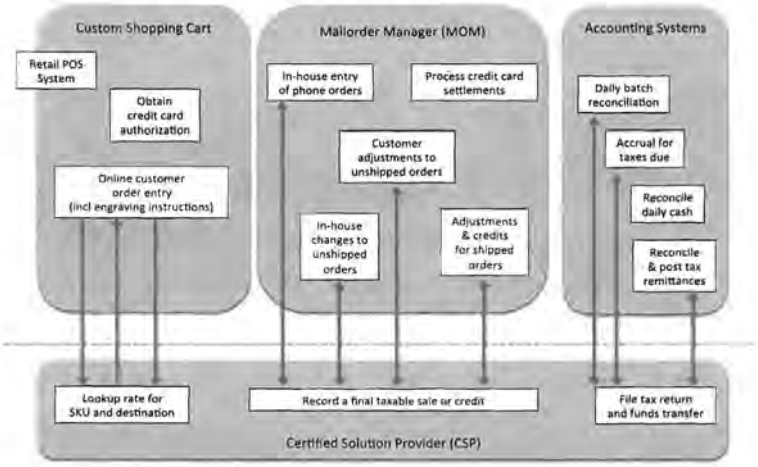
So, yes, fair compensation for the administrative costs and burdens is essential for all retailers, not just those selling to customers in remote states.

Costs for software integration and maintenance must be covered, too

Even if there were an "app" that could look-up a tax rate for an item and shipping address, retailers would still be faced with significant costs to integrate that app into existing systems, many of which include customized software.

This point was demonstrated when a small business called the *Silver Gallery* explained to the Streamlined Sales Tax Governing Board how they would incur nearly $22,000 in costs for design, programming, integration, testing, and employee training. This cost estimate was developed for the task of integrating "free" software into Silver Gallery's existing information systems, at each of the integration points shown in their diagram below.

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



That $20,000 represents just the up-front cost of software integration and testing. There would aslo be new costs for personnel to answer questions from customers and from the company's accounting and tax professionals.

As part of any federal mandate to collect sales tax for all states, Congress should require states to compensate businesses for reasonable costs of collecting sales taxes, including purchase and implementation of software. This compensation can most easily be accomplished by allowing retailers to

keep a percentage of taxes they collect on behalf of states. The higher costs that are incurred in the first year suggest that compensation percentages should begin at a higher rate, and decline over time to a rate of roughly 5%, as suggested by Overstock.

Thank you for posing these additional questions. I am happy to answer any other questions you may have on this issue.

Sincerely,

Steve DelBianco
Executive Director, NetChoice

United States House of Representatives
Committee on the Judiciary
Hearing on HR 3179, the "Marketplace Equity Act of 2011"
July 24, 2012
Questions For The Record
(Panel Two)

Questions from Representative Melvin L. Watt:

1. If services exist or are developed that sufficiently simplify the tax collection process for vendors, will a small business exemption be necessary?

Answer from Steve DelBianco:

Representative Watt, even with significant simplifications to state sales tax systems, a robust congressionally mandated small business exemption is still absolutely necessary.

What costs would a small business face if Congress forced them to pay sales tax to all 46 states? The Streamlined Sales Tax Project's (SSTP) own Cost of Collection[1] study found that a small business (under $1M in annual sales) spends 17 cents for every tax dollar it collects for the one or few states where it must already pay sales tax, as shown in the table below:

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You may be thinking that legislation before Congress would require states to provide software that makes it free and easy for retailers to collect sales taxes. But even if "free" tax software were available, it would only help reduce one element of costs documented above -- "Sales tax related software". At most, free software could relieve only 2 cents of the 17 cents in costs that retailers already incur for every tax dollar collected.

[1] *Available at* http://www.netchoice.org/wp-content/uploads/cost-of-collection-study-sstp.pdf

That leaves small businesses with a 15% cost burden on every dollar they collect, for things such as:

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

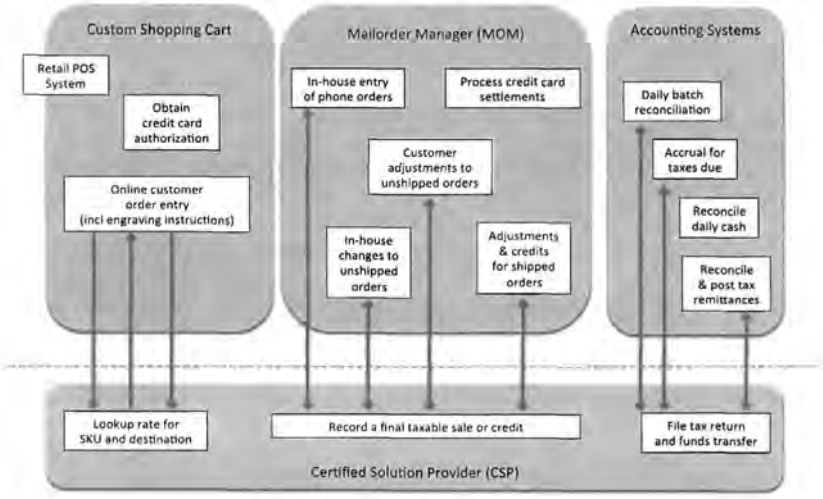
These collection burdens will be a big problem for small businesses that collect only their home-state sales tax today. Ask any of your small businesses, on main street or online, and you'll learn how hard it would be for them to begin collecting sales tax for all 46 states.

Costs for software integration and maintenance must be covered, too

Even if there were an "app" that could look-up a tax rate for an item and shipping address, retailers would still be faced with significant costs to integrate that app into existing systems, many of which include customized software.

This point was demonstrated when a small business called the *Silver Gallery* explained to the Streamlined Sales Tax Governing Board how they would incur nearly $22,000 in costs for design, programming, integration, testing, and employee training. This cost estimate was developed for the task of integrating "free" software into Silver Gallery's existing information systems, at each of the integration points shown in their diagram below.

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



Online marketplaces would impose additional costs to help with tax collection -- up to 20% of sales

Amazon.com is telling Congress that the company would charge only about 3% for its tax collection services. But Amazon won't collect taxes for a business unless the business *already* pays Amazon to host its web store -- for that, *Amazon charges a referral fee of 10-20% of the sale proceeds, plus additional fees.*[2]

So small businesses using Amazon's tax collection services might pay up to 20% of their sale proceeds, leaving little to pay employees and expand their business. And it increases the small business' reliance on expensive and established online marketplaces.

Question 2. What is the appropriate small business exemption threshold? Why?

Answer from Steve DelBianco:

Congressman Watt, you are right to worry about the many small North Carolina businesses that use the Internet to reach new customers. These new tax collection burdens would fall hardest on small businesses, who lack the personnel or systems to collect sales taxes for 9,600 jurisdictions in 46 states. As you say, the question is what would be an appropriate small business exemption threshold.

As I noted in answering your first question (above), retailers under $1 million in annual sales are already spending 17 cents on every dollar they collect for the one or few states where they are already collecting sales tax. But an online business doing $1 million in annual sales is typically just a sole proprietor or work-at-home entrepreneur.

So, the question remains, how high must we set the small business exemption to protect most small retailers, while still empowering states to collect the vast majority of uncollected sales tax?

Of the uncollected sales taxes from e-commerce in 2011, the top-500 e-retailers accounted for over 90% the non-collected taxes.

It is unwise—and unnecessary—to burden small business with new costs of tax compliance, since most of the uncollected sales taxes come from the top-500 e-retailers – presently those with more than $15 million in annual revenue.[3]

This is especially important when you consider that small businesses are the most vulnerable to these new costs of collection, and this "free" software comes with additional costs and often does not work as advertised.

By focusing on those retailers at the top end of the sales charts, states get most of the tax revenue while allowing smaller businesses to continue trying to grow into larger ones.

Congress should exempt businesses with less than $15 million in annual sales from any new tax collection mandate for out-of-state sales.

One way to set a realistic small seller exception is to exempt all businesses that are out on the "long tail" in terms of e-retail sales. For example, *Internet Retailer* publishes a *Top 500 Guide* each year, ranking

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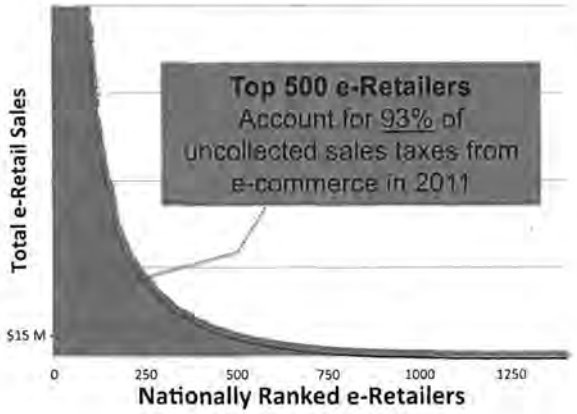
[2] Amazon Service Fees, http://www.amazonservices.com/sell-on-amazon/media-fees.htm/ref=amb_link_356743102_18?ie=UTF8&pf_rd_m=A2CA1KKALKCX2O&pf_rd_s=top-1&pf_rd_r=11SNTTXVHCER4S014KNK&pf_rd_p=1328499722&pf_rd_t=101&pf_rd_i=soa-faq-detail&id=AZFSSOAAS

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

the nation's largest retailers on their US e-commerce sales. For 2011, the #1 e-retailer was Amazon.com, at $48 billion in e-retail sales. Number 500 had just $15 million in remote e-retail sales. In total, the Top 500 had $181 billion in e-retail sales.

Economists Eisenach and Litan started with this Top 500 Guide when analyzing where each retailer already collected sales tax under *Quill*'s physical presence standard. Using their analysis, we estimated that the Top 500 were responsible for 93% of the uncollected sales tax on US e-commerce in 2011, as shown in the graph below[4] (netchoice.org/top500collect).



Congress could set a small seller exception that adjusts with inflation and retail trends by exempting sellers below the Top 500 cutoff from the previous year. Under this method, the small seller exception for 2012 would have been $15 million in annual sales.

That would leave exempted retailers with a more reasonable gross margin to cover expenses, *while allowing states to recover over 90 percent of the uncollected sales tax on e-retail.*

Congress must also Protect Businesses that exceed the Small Seller Exception of $15 million

However, even a $15 million small business exception won't be any help to a business approaching or exceeding that threshold. This includes businesses like North Carolina's National Wholesale.

National Wholesale was started in 1952 by Eddie Smith in Lexington, North Carolina. Today, National Wholesale primarily serves elderly Americans, and has grown to over 200 employees and annual sales well above the $15 million small business exemption level I suggested.

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

Presently, National Wholesale collects sales taxes for all its sales in North Carolina since that is where they have physical presence. But this is a challenge even in North Carolina because of the many different local tax rates: 6.75% in 76 North Carolina counties, 7% in 24 counties, and 7.25% in Mecklenberg.

National Wholesale tries to keep taxes simple for its many elderly customers who pay by check with a mail-in order form. So National lets its North Carolina customers use just a single rate to figure tax on their mail orders – the lowest rate in the state, or 6.75%. This means that for sales into 24 counties and Mecklenberg, National Wholesale pays the extra tax out of its own pocket. While National can afford to do this for its North Carolina sales, it would be far too expensive to absorb these extra taxes for an additional 45 states.

Catalogs like National Wholesale – along with their loyal catalog customers – need a single tax rate per state to make sales tax administration more manageable. Imagine the complexity and costs if catalogs had to list thousands of localities that have their own sales tax rates, and all the dates, rules, and thresholds for sales tax holidays in 46 states. One catalog company estimated it would take 26 pages to list tax rates and tax holiday information.

It's critical to note that none of the federal legislation before Congress today would force states to eliminate the complexity of local rates and of special rules for sales tax holidays.

To help businesses like National Wholesale who would not be protected by a small business exemption, Congress must require states to adopt radical simplifications to reduce administrative burdens.

As I noted in my hearing testimony, the True Simplification of Taxation (TruST) coalition developed a list of 12 minimum simplifications. TruST is a coalition that includes NetChoice, the American Catalog Mailers Association, the Direct Marketing Association, and the Electronic Retailing Association.

Twelve Key Simplification Provisions For Federal Legislation on Remote Sales Tax Collection

1. States must provide certified software for rate lookup, collection, electronic filing, and funds transfer. Users of the software would be immune from state and civil liability for errors in taxes collected.
2. A single sales tax rate per state for remote sales. (Required for customers who use mail-order catalogs and send checks with their orders)
3. States should compensate businesses for reasonable costs of collecting sales taxes, including purchase and implementation of software.
4. A single set of definitions for taxable and exempt products for all states.
5. A single audit on behalf of all states and local jurisdictions conducted by a single state where the seller has physical nexus, or a designated state in cases where a seller lacks physical nexus in any sales tax state.
6. There should be a common sales tax return for remote sellers to file. (Remote retailers should not be forced to file 46 separate state tax returns each month)
7. A single national rule for sourcing sales.
8. Harmonize sales tax holidays and thresholds, or give remote sellers an optional exemption from participation in sales tax holidays and thresholds.

9. Allow remote sellers to challenge states in federal district court for disputes on sales tax collection, including whether a state is following congressionally required simplifications.
10. Preempt and preclude state laws imposing sales tax obligations on businesses with no physical presence in that state. (Once Congress creates this path to tax collection, the states must follow this one path, and stop trying to stretch the definition of nexus beyond physical presence)
11. Collection of sales tax under federal legislation does not create nexus for any other business purpose.
12. A congressionally-determined exception for small businesses.

TruST believes that *all* of the 12 Principles are necessary for Congress to require true simplification and hold states accountable to the law. TruST members have met with several Congressional offices and would be willing to discuss these principles at any time.

Thank you for posing these additional questions. I am happy to answer any other questions you may have on this issue.

Sincerely,

Steve DelBianco
Executive Director, NetChoice

Additional Material submitted for the Record

Written Testimony of the American Catalog Mailers Association Regarding the Committee on Finance of the U.S. House Committee On The Judiciary
Hearing on Marketplace Equity Act of 2011
July 24, 2012

HAMILTON DAVISON
PRESIDENT & EXECUTIVE DIRECTOR
AMERICAN CATALOG MAILERS ASSOCIATION
WASHINGTON, DC
1-800-509-9514
www.catalogmailers.org

The American Catalog Mailers Association (ACMA) thanks Chairman Smith, Ranking Member Conyers, and the House Judiciary Committee for this opportunity to present its views on the efforts of states to impose tax and tax collection obligations on retailers located outside of their states and who have no physical presence in those states, all per the Marketplace Equity Act of 2011, H.R. 3179. The bill would give states the authority to require out-of-state businesses to collect sales or use taxes. Such efforts represent neither federal nor state tax reform, but merely states seeking to impose a 1930s tax regime on 21st Century commerce rather than reforming their tax regimes and seeking Congressional help. Effectively, states impose business activity taxes on companies with no physical presence, no employees, and no political voice in the state. Such a move is bad for the economy, hurtful to the affected companies, moves the marketplace toward less equity, and fails to solve acute revenue issues for states and municipalities.

Founded in 2007, ACMA is the only industry association that advocates specifically for catalog marketers. As the primary voice of the Catalog Industry, ACMA represents its members on issues that directly concern their immediate and long term commercial interests such as tax issues, postal rates, regulations and technical matters; environmental issues; and regulatory and government relations

ACMA is also a member of TruST, the coalition for True Simplification of Taxation, a recently-formed group whose association members are all filing written testimony that

ACMA has read and concurs with. More information on TruST can be found at www.TrueSimplification.org.

As part of this written testimony and our presence at the hearing, ACMA would like to respond to a the charge that "real companies do not care about this issue." To illustrate how erroneous a claim this is, ACMA has gathered nearly six dozen letters from remote marketers — primarily companies that sell via catalogs — all of whom explain in specific detail the harm this bill would cause their companies, growth, and most notably their employment. It is notable that this quantity of letters was assembled in only a few business workdays between the notice of this hearing and the deadline to submit testimony. This underscores the veracity of opposition to H.R. 3179 and clearly addresses concerns that no real opposition to this change exists.

1. BACKGROUND

ACMA would like to address the current movement rallying behind the so-called Marketplace Fairness Act. The bill is hardly fair and would do much harm to the marketplace. It presents a serious threat to catalog, online, and other direct marketers because it would require the collection of sales taxes in more than 9,600 state and local tax jurisdictions, with differing rates, taxable product categories, definitions, sales tax holidays, and reporting and audit requirements. If enacted, it would result in lost sales, confused customers, daunting administrative burdens, repetitive audits, and expensive assessments without impartial recourse. The market value of direct marketing businesses would be similarly affected.[1]

The argument that current nexus standards result in an "uneven playing field" is patently false. National retail chains receive many state and local tax benefits and other incentives to locate stores in particular areas. These include rebates of property and sales tax (TIFs), subsidies for utility lines, training allowances and tax deductions for new hires, etc. Employees of business located within a jurisdiction use education and public services. Remote sellers get none of these government benefits, yet would be burdened with collection of the tax to fund these subsidies. In fact, remote sellers are obliged to pay these taxes whether or not they collect them from customers, effectively making this a new tax on remote marketers.

The U.S. Supreme Court in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), ruled that without specific authorization from Congress, states could not impose tax collection burdens upon remote sellers that have no "physical presence" as this would interfere with interstate commerce. Moreover, if allowed by Congress, the myriad of state tax jurisdictions with resulting variance in rates, definitions, and audits would create a complex and administratively costly nationwide sales tax collection system. The costs of that collection are a tax on the out-of-state business.

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[1] Abe Garver, Focus Investment Bankers as originally published on Seeking Alpha on October 9, 2011 and also found at http://www.focusbankers.com/publications/articles/Valuations/articles_webonlyretailers.asp

2. HARDSHIPS ON BUSINESSES

Consider the potential situation of one ACMA member, National Wholesale, which is based in Lexington, N.C. This 60-year-old, family-owned and operated company is very much the catalog mail order equivalent of a main street store. National Wholesale provides a full line of clothing, undergarments and shoes tailored to meet the special needs of mature female customers from across the country. A sizable number of National Wholesale's customers are in their 70s, 80s and even their 90s. More than one-third of the company's orders still come in an envelope with check enclosed. Many of their customers rely on mail order purchases of products from National Wholesale that are simply not available locally, and a large majority of their customers do not have access or are not comfortable using a computer or the internet to order.

Like many catalog marketers that operate out of a single state, on the order form of all National Wholesale catalogs is a note indicating "North Carolina residents please add 6.75% sales tax." (See Appendix I for a picture of a National Wholesale order form.) Despite this simple directive, many of National Wholesale's customers still get this wrong either by paying the wrong rate or not paying the tax at all. Imagine if the company's catalog order form had to have a list with the tax rates from more than 9,600 taxing jurisdictions for customers to decipher. It would be impossible for National Wholesale to explain the taxing across all the different jurisdictions in the limited space available on a printed order form. And if the older consumers the company serves are confused on how to calculate the tax, or which rate should apply, there's a very good chance they just won't order at all.

For the elderly ladies who are confused with what's going on with sales tax, National Wholesale would end up absorbing the unpaid tax rather than chasing after customers for the unpaid or under-paid tax. The significant harm to their business in chasing after customers over unpaid or incorrectly remitted sales tax would be twofold: the cost burden of collecting from their customers would be substantial and unsustainable, and the confusion, irritation and negative feelings their customers would have toward the company over their shipments being held up pending payment of sales taxes would cost the company many of its customers.

As a small company, National Wholesale would also face the tremendous burdens of trying to figure out whether the tax is correct or not, remitting it to all these jurisdictions, and being subject to sales tax audits from all those different taxing jurisdictions.

Also consider the hardship another ACMA member, the Miles Kimball Company catalog, based in Oshkosh, WI, would face. Nearly two-thirds of this company's customers are 65 years of age or older; in fact, almost half its customers are 70 or older. Among all its customers, one-third of them still make their catalog purchases by mailed-in orders using personal checks. Needless to say, Miles Kimball faces the same impossible task of having to explain the assorted taxing jurisdictions as National Wholesale does.

Although a majority of catalog customers pay by credit card and another majority of such customers order online, the education and conversion processes for collecting from so many taxing jurisdictions around the country are almost as difficult as the two ACMA members referenced here.

Some seeking to overturn the *Quill* precedent legislatively claim that this matter can be handled quickly and efficiently with free look up software, or that concerns of complexity and cost are overstated. This simply is not the case. Each remote marketer has invested substantial resources to build enterprise software systems that run their businesses. Everything that touches or relates to the order flow or the revenue flow of the business is affected including those modules that track inventory, take orders and maintain order history, and bill customers to collect revenues. All company legacy systems need to be modified to account for this change, imposing a significant conversion burden on remote marketers. Also required are ongoing maintenance costs to keep descriptions and tax requirements up to date, ongoing training of customer service personnel, and additional financial reporting and compliance.

If the benefit were significant for the states and municipalities involved, then perhaps this extra cost might be justifiable. The reality is that forcing remote marketers to collect and remit sales and use taxes will add less than 1% to the total current tax collections for states and municipalities nationwide.

H.R. 3179 puts tens of thousands of remote marketing companies at risk of failure. A perusal of the letters assembled in short order and submitted to the House Judiciary Committee bear this out as owners and executives document the specific harm the collection of sales and use taxes represents to their businesses.

Remote marketing also supports a large supply chain of "mom & pop" businesses, inventors, artists and artisans, manufacturers, distributors and importers who often lack the scale necessary to distribute via large national retail chains. Moreover, remote marketers necessarily draw on a large variety of vendors and supply chain partners in the creating of catalogs, design of websites, and operation of businesses that would also be adversely affected by H.R. 3179.

Should H.R. 3179 be put into law, many smaller catalogers will find it almost impossible to compete as already thin profit margins erode further. Putting an entire sector of the economy and the many jobs they represent at risk for such a small change in tax collections simply is not cost justifiable.

3. HARDSHIP ON CONSUMERS

In addition to their positive impact on the national economy, it should be noted that remote marketers play an important role in meeting distinct consumer needs and requirements, needs that are not generally met by large, sophisticated retail chains.

Catalog and internet sales allow consumers to efficiently select goods that may not be readily available in their local market. They allow convenient shopping for single parent households or dual income families where the adults have precious little free time during typical store hours. They bring a variety of hard to get or unique products to the market that do not have large enough demand to be carried in traditional "brick and mortar" retail store locations. They provide privacy to purchase merchandise that is embarrassing or uncomfortable to purchase in a retail shopping environment. Remote sellers cater to the needs of rural Americans, disabled consumers and older shoppers who may have difficulty driving or walking.

In fact, remote marketing and catalogs specifically bring a wide variety of social, cultural and economic benefits to Americans that are not otherwise available. See ACMA's white paper "*The American Catalog Experience: Catalog Marketing's Social Importance to American Consumers & Culture*," attached herein as Appendix II. We ask that this be incorporated into the hearing record.

4. CONCLUSION

The physical presence requirement from the *Quill* law must remain for the collection of sales and use taxes. If that law is to be changed, it must not be done so without significant simplification reform of state sales tax regimes and the establishment of a fair and impartial dispute resolution mechanism. Our national economy is in no position to afford such a burden absent statutorily-mandated simplification and dispute resolution provisions also being included in the law.

ACMA urges Congress to uphold both the current *status quo* of the twice-tested *Quill* precedent and to take the time to investigate the implications on all remote marketers prior to making any change to the existing laws.

APPENDIX I:

YOUR ID#

CATALOG CODE 186

National WHOLESALE CO., INC.
4700 NATIONAL BLVD.
LEXINGTON, NC 27294

FOR OFFICE USE

SHIP TO A DIFFERENT ADDRESS
☐ WORK ☐ NEW
☐ GIFT ☐ TEMPORARY
Name
C/O
Address
City State Zip

IF NAME OR ADDRESS IS INCORRECT, PLEASE MAKE CORRECTIONS AT RIGHT.

PLEASE CHECK (✓) METHOD OF PAYMENT:
☐ I am enclosing my check or money order. (Make payable to National Wholesale Co.)
☐ Charge my purchase to my:
☐ Master Card ☐ Discover Card
☐ American Express ☐ VISA
Bank Credit Card No. (Print ALL Digits)
Mo. Yr.
Card Expires
Signature
May we have your phone number in case we have a question concerning your order?
Area Code Phone Number
E-mail address
To help us choose merchandise of greater interest to you, please tell us:
What is your date of birth? MONTH YEAR

ORDER FORM — Shaded area is sample order

	STYLE NO.	QUANTITY	SIZE	*Shoe Width *Bra Cup	COLOR	PRICE	TOTAL PRICE
	#1234	2	34	C	White	$24.95	$49.90
1							
2							
3							
4							
5							
6							
7							
8							
9							
10							

Shipping and Processing:
Up to $20.00 ..... $4.95
$20.01 to $40.00 ..... $6.95
$40.01 to $70.00 ..... $8.95
$70.01 to $100.00 ..... $9.95
$100.01 to $150.00 ..... $10.95
$150.01 and over $11.95

AMOUNT OF ORDER
NC Residents Add 6.75% Sales Tax
SHIPPING AND PROCESSING
Rush Delivery add $7.95 to your order (see box below)
TOTAL AMOUNT

Our Gift Certificates Make Great Gifts!
Give your loved ones freedom of choice-while you save time and money!
Available in amounts of $25.00 or more.
Order now by phone, mail or fax.

SATISFACTION GUARANTEED!
Your National purchase is guaranteed to give you 100% satisfaction in every way, or we will cheerfully replace it or refund your money, no questions asked.

Ship by Rush Delivery for only $7.95 more!
Speedy 3-4 business days delivery on in-stock items ordered by 1 p.m. EST.
Simply add $7.95 to the shipping and processing charges (see box above).
Please note, delivery may take longer to APO, FPO, and U.S. possessions.

CREDIT CARD ORDERS ONLY: Call 1 800-480-4673 ANYTIME
FAX Your Order: Fax 1-336-249-9326 ANYTIME
CUSTOMER SERVICE: Call 1 800-433-0580 Mon.-Fri. 9:00 a.m. to 6:00 p.m. EST Sat. 8:00 a.m. to 12:00 noon EST
To help us be more efficient, please have ID # and catalog code ready when calling.
Also shop online: www.ShopNational.com

BE SURE TO GIVE: SIZE • COLOR • STYLE NUMBER

THANK YOU! ALL OF US AT NATIONAL APPRECIATE YOUR ORDER

AMERICAN CATALOG MAILERS ASSOCIATION

APPENDIX II:

The American Catalog Experience:
Catalog Marketing's Social Importance to American Consumers & Culture

Catalogs Bring *A Variety of Good* to Americans

Overview

The catalog industry has a wide-sweeping impact on American culture, well beyond the economic benefits of employing millions of people, paying millions in federal, state and local taxes, and conserving energy and natural resources. The American catalog experience has significant and important social benefits to American culture and consumers.

Catalogs are Good for American Consumers and Our Quality of Life

- Catalog shopping is convenient and available 24/7/365 from one location accessed by mail, telephone or online. Oil consumption, traffic congestion, and parking are not factors.
- Catalog shopping is unconstrained by geography, thus eliminating physical and distance boundaries. Catalogs put a world of products in the hands of Americans.
- Catalogs allow instant service whenever and wherever people wish to shop. They are accessed anywhere, home or business.
- Catalogs define "universal access" for merchandise and commerce.
- Catalog shoppers consistently report it is easier to get detailed product knowledge and excellent customer service over the phone than elsewhere (or even to find a sales associate). There is usually no or little waiting time to get help.
- Catalogs fight the homogenization of products driven by retail consolidation ("the Wal-Mart-ization of America"). Retail economics force aggressive rationalization of merchandise assortment. If retailers do not sell a high number of pieces per individual store, they cannot exist. If catalogers, who usually offer a much broader assortment, do not sell a high number of pieces nationwide, they cannot exist. Retail and catalog are different business models and both are important for the growth of the American economy.
- Catalogs create an easy way to comparison shop without necessitating multiple trips to different stores.
- Catalogs make sending a birthday, holiday or special occasion present to anyone, anywhere a convenient pleasure, helping Americans stay connected in an increasingly mobile society.
- Catalogs allow people to shop for potentially embarrassing products in the privacy of their own home without worrying about being out in public — for instance, a cancer patient buying a wig, or consumers buying unusual or plus-sized clothing in the privacy of their home rather than in public at stores. Personal hygiene, medical and disability-related products are frequently purchased from catalogs for enhanced privacy.
- Some of the specialty products sold by catalogs includes diabetes-related products, organic products, business productivity tools, pharmaceuticals, and other specialized goods for which a ready retail market might not otherwise exist.
- Catalogs contribute to the quality of life by providing a convenient, fun, compelling leisure time experience. Recreational shopping is an important pastime for many Americans.
- Catalogs remain part of a shared experience in America that remains relevant, human and enjoyable in the increasingly impersonal age of ecommerce and electronic media.

- Catalogs form part of our collective experience. Who doesn't remember the childhood pleasure of paging through the often-remembered Sears Wishbook catalog?

Catalogs are Good for the Environment

- Catalogs may be America's biggest carpool.
- Catalogs have a low carbon footprint and are becoming more environmentally friendly every year. Yes, catalogs use paper, but the modern advances in forestry management have made trees a sustainable crop. In fact, there are more trees in North America today than there were at the time of Columbus's voyage. Plus, advances in the recycling of paper continue to develop and it takes 60% less water and energy to make recycled paper than to break lignin into virgin fiber. Please see www.catalogmailers.org for more information on «Catalogs and the Environment».
- Catalogs make the phone ring, a nearly environmentally neutral communications method in a society increasingly aware about ways to cut our carbon footprint.
- With very few exceptions, catalog companies demonstrate responsible mailing practices, honoring consumer demands concerning mailing frequency, contact methods, and individual consumer needs and wishes. Catalogers are, by the precise and stringent economics of cataloging, self-regulating, and cannot afford to do otherwise.

Catalogs are Good for the Economy

- Catalogs stimulate consumer demand, both for direct and retail, fuelling the largest engine of economic activity we have.
- Catalogs are highly targeted and merchandised to meet specific consumer interests and needs, thus representing an effective and efficient marketing channel to maintain and strengthen American competitiveness.
- Catalog brands have a long-term relationship with Americans that is part of the shared American experience. The ability to come back to trusted brands and companies for the things we need, knowing the consistency and helpfulness we will find as consumers can be relied upon again and again. This is a high ideal of American commerce.
- The robust American catalog shopping experience allows for a shift in power from the retailer to the consumer.
- Catalogs are mailed predominately to willing customers who may have a pre-existing relationship with retailers, or to those consumers who have requested a catalog from a company they are interested in shopping with, or to other "opted-in" consumers who have expressed interest in receiving marketing information or specific offers.
- Catalogs help small businesses succeed.

Catalogs Encourage Small Business

- Catalogs allow many small businesses to quickly and efficiently access specialized products that keep them competitive despite their niche focus, small scale or remote location.
- Catalogs efficiently and effectively serve niche avocations and vocations, serving Americans and allowing these businesses to be productive at a lower cost of operations. They help "level the playing field" with larger companies that have more extensive sourcing operations.
- Catalogs provide an important distribution option for small- and medium-sized manufacturers, importers, wholesalers, inventors and designers, all of whom do not have the scale, sophistication or capital to sell their products to the "Big Box" retail giants, which demand prices that are impossible to meet.

- Catalogs provide a national market test for new products and the discovery of small niche market opportunities that would otherwise require large budgets and sophisticated deployment. This creates greater innovation and broader consumer solutions than would be possible otherwise. For example, the electronic thermometer, which is now a standard for families with newborns, was developed in exactly this manner.
- Catalogs provide a national audience for small companies and start-up operations, helping keep small business as the largest creator of jobs in our economy.

Catalogs are Good for Disadvantaged and Rural Americans

- Catalogs can be the only alternative for shut-ins, infirmed, handicapped, elderly or those with limited mobility.
- Catalogs provide viable shopping venues for rural citizens who live too far from stores.
- Catalogs provide the older population with well-being benefits. The regular contact with letter carriers and delivery service providers who deliver packages to the home reduce the sense of isolation and provide beneficial human contact and a "safety-net," helping seniors stay connected to the community and creating a sense of normalcy so critical to well-being and mental health.
- Catalogs enable people to lend a helping hand to those they do not know, including the poor, destitute or imperiled throughout the world (consider, for example, Heifer International, CARE, NWF or other nonprofits that have catalog businesses).
- Catalog companies do not have to be located in urban centers and can instead create quality jobs for rural America. High-employment catalog companies are found in locations such as Freeport, Maine; Dodgeville, Wisconsin; Dyersville, Iowa; and many other remote locations.

Catalogs, Their History, and Their Role in American Commerce

- Interstate commerce developed because of catalogs.
- Rural free delivery was spurred on by catalogs.
- Parcel Post developed the required scale due to catalog shipments.
- Early catalog brands were among the first to have a national identity.
- More than half of America shops via catalogs.
- Catalogs allow marketers to have a national footprint without being a mass merchant, having helped develop the idea that we can have national brands without the requirement to open stores in every state.
- Baby Boomers buy more from catalogs — per capita — than any other generation.
- Catalog use increases with the age of the consumer, particularly pertinent in "the graying of America."
- Catalogs provide important content to keep mail relevant and welcome in the household.
- Cataloging did $270 billion in sales in 2006 and supported more than 20,000 different firms, as well as thousands of supplier companies and service vendors.
- Cataloging economics fundamentally changed in 2007 and have spurred industry-wide experimentation to reduce mail volumes, down 35% two short years later. That's a figure that will likely continue to grow once catalogers perfect non-mail marketing techniques.

Catalogs and the Internet

- As a whole, catalogers were pioneers in the use of the Internet for the sale of products and services to consumers and businesses.
- By in large, catalogers receive about half their orders online depending on the product category and demographic they serve—yet the paper catalog is responsible for generating

more than half a company's online sales (some companies report it is upwards of 90%). The symbiotic relationship between the paper catalog and online technology yields greater convenience for everyone from single, working moms to full families, to the elderly, to the physically handicapped, further driving social and environmental benefits, time and efficiency.

- Catalogs are also drivers of retail traffic, promoting commerce, jobs, and convenience for brick and mortar retailers.
- With rare exception, every cataloger has sophisticated e-commerce deployment, making full use of all established and most emerging, technologies.
- Catalogers largely do not distinguish between mail and Internet as business objectives. They see it as being about communicating with people in the way they want to be reached via media consumers already use. It is also about using the most efficient and desirable means possible to stay in touch with customers. The combination of the catalog plus the Internet creates a very powerful marketing and distribution system that impacts and improves lives.
- Catalogs establish brands then extend those brands' reach to the Internet, offering Americans hard-to-find products at value-based pricing.
- Catalogs help consumers feel confident about online purchases. Catalog merchants have a long and protected tradition of honoring their commitments as responsible, customer-oriented, integrity-driven businesses.
- Catalogs prompt people to tell others through social media (i.e., blogs, Twitter and Facebook) about the products that inspire. This "viral" effect of community and commerce has multiplicative financial and emotional benefits. It also increases consumer satisfaction and marketer responsiveness by providing a ready forum for customer comments, reviews and feedback.
- Catalogs provide an alternative transactional method for those Americans concerned about online privacy or transactional safety.
- Catalogs still have the highest order response of any vehicle available to direct marketing. Consumers "vote with their feet." This indicates that a great deal of value is put on the receipt of a catalog that creates a residual benefit for both online commerce and the American economy.

Conclusion

Since the mid-1990s, many experts have predicted the extinction of the printed catalog. However, until the double-whammy of the huge postage increase of 2007 and the Great Recession of 2008-2009, catalogs in America continued to thrive, aided and enhanced by the maturation of Internet marketing. As both the general economy and postal rates settle down, it will be proven that "rumors of catalogs' demise" continue to be over-stated.

With catalogers' continuously responsive use of recycled paper and tree replanting, as well as their close attention to self-regulation, this responsible industry is primed for greater growth going forward.

Last revised: July 22, 2012

July 17, 2012

Chairman Lamar Smith
House Committee on the Judiciary
2138 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Smith:

When government picks winners and losers in the private sector, more often than not, there are a lot of losers.

In the case of the solar energy company Solyndra, the American taxpayers lost the most. After receiving a $535 million loan guarantee gift from the Obama Administration, Solyndra famously went bankrupt and was raided by the FBI. Last November another energy company -- Beacon Power Corp. – filed for bankruptcy after receiving a $43 million government loan guarantee. So much for picking winners.

Good conservatives have been unrelenting in their efforts to end the practice of picking winners and losers in the federal appropriations process, but inequities remain throughout the budget. The United States Tax Code is even worse, an antiquated mess of laws difficult to understand and even harder to navigate, for both families and businesses alike. As our nation faces grave economic challenges, we must take action now not only to spur private sector growth in the immediate future, but ensure our economic security and dominance for generations to come.

Just as government must discontinue asserting bias in the marketplace, it is also necessary to end this practice in our tax policy. Specifically, it is time to address the area where prejudice is most blatant – our sales tax policy toward Internet sales. At issue is the federal government exempting some Internet transactions from sales taxes while requiring the remittance of sales taxes for identical sales made at brick and mortar locations. It is an *outdated* set of policies in today's super information age, when families every day make decisions to purchase goods and services online or in person. Moreover, for a free market economy, it's unfair, punitive to some small businesses and corporations and a boon for others.

This is why the American Conservative Union applauds Rep. Steve Womack's leadership with the introduction of the Marketplace Equity Act of 2011. **Let me be clear: it is NOT a tax increase.** Rather, these are sales taxes owed but not presently collected. The government should not be in the business of picking winners and losers, and punishing brick and mortar businesses in favor of Internet sales.

In the words of Indiana Governor Mitch Daniels, *"[S]ales taxes that [states] impose ought to be paid, and paid by everybody equally and collected by everybody in the retail business ... We're not talking about an additional or new tax here – we're talking about the collection of a tax that's existed a long time."* (Marketplace Business, 1/12/12)

American Conservative Union
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As conservatives we know that governmental power can be used to destroy entrepreneurship, innovation and the free market. There is no more egregious example of misguided government power then when taxes or regulations affect two similar businesses completely differently.

Over time the company that has to comply with a tax or a regulation will lose market share to its competitor who is carved out from this government interference. In these cases the winner is not the company who outcompetes, but the one who gets special privileges from the government.

At its inception, the Internet was everyone's darling, the latest example of American innovation and ingenuity. Internet sales represented a miniscule portion of the total retail market, and the novelty led to tax loopholes and unintended consequences. Now, according to Forrester Research, Internet sales account for nearly 10 percent of all sales of products and services in America, with an annual growth rate of about 9 percent.

If Congress does not confront this issue, state and local governments dependent on sales taxes will need to look for other sources of revenues as Internet sales continue to expand. Policy which allows for both online and brick and mortar retailers to be susceptible to the same taxes will — and should — allow for commensurate reductions in sales tax rates. For instance, if Internet sales tax revenues will add 10 percent in revenue to a governing body's coffers, then, at a minimum, a corresponding overall reduction in rates should apply.

There is also the question of empowering our states pursuant to their 10th Amendment rights. The current system is inconsistent with states' rights, and the Congress ought to carefully consider enacting revenue neutral tax reform policies consistent with the 10th Amendment.

It is the cruelest form of economic discrimination when the government looks at two similar economic transactions and arbitrarily decides to saddle one with a tax. At the same time, federal and state authorities need to stop playing favorites when it comes to the treatment of identical goods and services.

This tax discrimination should be vetted more thoroughly, because the government should not be picking winners and losers in the marketplace through the power of taxation. We need to ensure entrepreneurs can operate in an economy where the rules are clear and no one person or company gets special treatment from the government.

The free market system can only operate effectively on a level playing field of free and fair competition. Whether it's Solyndra, or sales tax, or a multitude of other policy decisions that impact the private sector, the government picking winners and losers is a perversion of the free market system. Lawmakers on Capitol Hill – especially conservatives – ought to at least acknowledge this when considering important reforms to the tax code.

The Marketplace Equity Act of 2011 begins this conversation. It's not a perfect bill, but it's a critical beginning to this dialogue. And, rest assured, we will not be party to or stand for Trojan Horse legislation that claims to strive for equity in the law merely to serve as a cloak for secret tax increases.

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We know as conservatives that it is time for our country to tighten our belts, be honest with the American people and fundamentally change our tax system. We have a great opportunity to drastically lower rates, especially the corporate rates, and eliminate esoteric tax preferences. We need a flatter, fairer tax code. One that doesn't pick favorites.

Sincerely,

Al Cardenas
Chairman, The American Conservative Union

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July 24, 2012

House Committee on the Judiciary
2138 Rayburn House Office Building
Washington, DC 20515

Submission of Comments for the Record
United States House of Representatives
Committee on the Judiciary

Hearing on: H.R. 3179, the "Marketplace Equity Act of 2011"
Tuesday 7/24/2012 - 10:00 a.m.
2141 Rayburn House Office Building

Submitted by:
Carey Verger, Vice President of Tax, Airgas, Inc.

Airgas, Inc. is the largest U.S. distributor of industrial, medical, and specialty gases, and hardgoods such as welding equipment and safety supplies. Airgas is also a major producer of certain industrial gases and a leading distributor of process chemicals, refrigerants, and ammonia products. Radnor, PA-based Airgas is proud to employ more than 15,000 people at over 1,100 locations in the U.S. We support H.R. 3179, the Marketplace Equity Act of 2011, as necessary legislation to strengthen our economic policies and achieve basic principles of fairness.

Airgas is a growing company with a physical "brick and mortar" presence across the U.S. (a local presence, nationally). Although we collect sales and use tax from our customers in nearly every tax jurisdiction in America, some of our competitors don't because they sell their products through remote channels — by telephone, mail, and online, into states where they have no physical presence. This is a clear inequity that leads to lost tax revenue to states. It hurts businesses that have invested in communities, giving remote sellers a 5 percent to 10 percent price advantage.

We believe federal legislation is needed to require equitable sales and use tax collection for all retailers, regardless of location. States should have the ability to enforce their existing sales and use tax laws and be able to decide whether or not to collect taxes that are already owed to them under state law. This is a key issue of states' rights and it has important economic implications for the health of local governance and main street businesses.

The Supreme Court, in its 1992 *Quill* decision, ruled that remote sellers, who didn't have a physical presence in the purchaser's state, could not be required to collect state sales tax. The explosion of the Internet over the last 20 years, and improvements in express mail delivery have made remote selling of commodities nearly as common as local selling. Things have changed quite a bit since the Internet and on-line shopping came onto the scene, and Congress needs to address those changes now.

In response to the Supreme Court's concerns, the Streamlined Sales and Use Tax Agreement (SSUTA) was developed to assist states in administering a simpler and more uniform sales and use tax system. Twenty four states have already enacted legislation to implement the terms of the SSUTA. However, some states appear to be unwilling to implement the terms of SSUTA until federal legislation is enacted to require out-of-state sellers to collect existing sales or use taxes.

State taxation of *all* remote sales would help level the domestic playing field between large national businesses selling remotely and small local traditional businesses. Providing for state taxation on all sales will end a discriminatory tax practice. The current system centralizes retail sales and results in struggling local economies. Equalization would also increase state government tax revenues — as much as $23 billion in 2012 — a significant factor in a period of tight budgets.

Straightening up this outdated system is a clear, simple step to help restore fairness in our country's fiscal policy. Airgas provides building blocks for the American economy. We supply the construction, health care, energy, transportation, and other industries with critical products and services. We are proud to have local presence throughout the United States and look forward to continuing our work in promoting local, regional, and national economic development. Accordingly, we encourage Congress to enact legislation for state taxation of remote transactions, like Internet sales, that reflects the realities of modern commerce and helps ensure that all U.S. companies are treated equally, and fairly.

Before the House Judiciary Committee

Hearing on H.R. 3179, the "Marketplace Equity Act of 2011"

Statement of the
Consumer Electronics Association (CEA)
July 24, 2012

Chairman Lamar Smith, Ranking Member John Conyers and members of the Committee, on behalf of the Consumer Electronics Association (CEA), thank you for the opportunity to submit a written statement for today's hearing on H.R. 3179, the "Marketplace Equity Act of 2011."

CEA is the preeminent trade association representing American innovators and entrepreneurs, both large and small, who are consumer technology companies. CEA's over 2,000 corporate members include manufacturers, Internet providers and retailers. Our members design, produce and sell products and provide services that enable millions upon millions of consumers every day to access the wonders of the Internet.

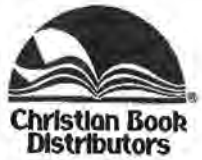
As you know, there is currently a large loophole impacting the collection of state sales tax on products bought online from out of state remote sellers, which is harming traditional brick-and-mortar retail businesses. We believe that **H.R. 3179**, the "Marketplace Equity Act of 2011", a bipartisan bill with 48 cosponsors, is an effective solution to rectify this inequity in today's marketplace while assisting U.S. states in collecting approximately $23 billion in uncollected state sales taxes.

First, let it be clear that the "Marketplace Equity Act" **would not** enact new taxes. The legislation simply closes a loophole created by a decades-old Supreme Court ruling, issued in 1992 before the pervasiveness of Internet commerce. The ruling prohibits states from requiring remote sellers to collect sales and use taxes owed on purchases from out-of-state vendors.

This loophole has created an unfair price disadvantage for brick-and-mortar retail businesses and has placed an undue burden on consumers who do not realize they owe the sales tax if it is not collected by the seller. It has cost the retail sector thousands of jobs. Additionally, in the year 2012, this loophole will cost state and local governments $23 billion in uncollected sales and use taxes.

We believe that the Marketplace Equity Act represents the best thinking of all the stakeholders by providing a roadmap forward for states to collect sales taxes, simplify their sales tax statutes, and assist vendors with compliance, while providing for a robust small business exemption.

To put it simply, it is common sense legislation that will help states with their own budget shortfalls without increasing the federal deficit, help curb retail job loss and close a decade old loophole that will level the playing field for all online retailers.



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July 20, 2012

VIA FAX: 202-225-5915
978-531-1996

The Honorable John F. Tierney
US House of Representatives
2238 Rayburn HOB
Washington DC 20515

Dear Congressman Tierney:

The House Judiciary Committee is holding a hearing July 24th to discuss overturning a twice-vetted Supreme Court decision (1967's *National Bellas Hess* ruling and 1992's *Quill* decision that upheld the 1967 law) that holds the imposition of chaotic state and local sales taxes constitutes a significant barrier to interstate commerce. This Constitutionally-protected right is what enables our national economy to grow.

If we are forced to comply with the provisions envisioned in H.R. 3179, our business located in Peabody, Massachusetts, of which we employ between 500-700 employees throughout the year, will be severely harmed, with implications for our employment outlook. Our company will be facing numerous challenges including an eroding revenue stream and an increasing cost structure. We do not have the means or the manpower to possibly monitor and prepare sales tax returns for over 9,500 different taxing jurisdictions throughout the United States. Changes would have to be made in all areas of our business processes, including, but not limited to accounting, order entry, order processing, reporting, etc. We would have to contract with an outside agency to handle the preparation of the additional sales and use tax returns that we would be required to file under the Market Place Equity Act of 2011. We will have additional staff requirements along with inquiries and audits from numerous taxing jurisdictions. In addition, we do not have nexus throughout the U.S. We file tax returns where we have nexus; for us to file where we have no connection to a state or jurisdiction defies all sense of logic. For various jurisdictions that collect sales and use taxes, they will basically be using us as a collection agent. If this law is passed, it will have a negative impact not only on our top line, by any rational means of measurement, but will have an effect on other related companies with whom we do business including those in the shipping industry.

We would like to register our strong opposition to H.R. 3179 in its current form. We think there are sound policy reasons to preserve the status quo, but even if you choose to change the *Quill* decision, we urge you to write safeguards into statute so small- and medium-sized businesses can cope with the complexity this brings.

We can demonstrate that requiring all remote sellers to collect sales tax will add less than 1% to total state and local tax revenues. We can point to the Commerce Department's own statistics to show that more than 90% of the dollars transacted on the Internet are B2B for which most every dollar is already being collected in use tax. This is not a cure all for state and local revenue shortfalls. At the very least, there is time to do this right without unintended consequences. This is not the time to be putting more jobs at risk, especially at small- and medium-sized businesses, which make up the backbone of the employment in America.

Thank you for your urgent consideration of this matter.

Sincerely,

Richard W. Corner, CPA
Executive Vice President & CFO

cc: Committee on the Judiciary, US House of Representatives, via fax: 202-225-7682
Courts, Commercial and Administrative Law Subcommittee via fax: 202-225-3746
American Catalog Mailers Assn., Inc., via fax: 401-331-0400
Senator Scott Brown

STATEMENT OF THE
DIRECT MARKETING ASSOCIATION
REGARDING THE
COMMITTEE ON JUDICIARY
OF THE
UNITED STATES HOUSE OF REPRESENTATIVES
HEARING ON
MARKETPLACE EQUITY ACT OF 2011
July 24, 2012

JERRY CERASALE
SENIOR VICE PRESIDENT, GOVERNMENT AFFAIRS
DIRECT MARKETING ASSOCIATION, INC.
1615 L STREET, NW SUITE 1100
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202-861-2423

I. INTRODUCTION

The Direct Marketing Association (DMA) thanks Chairman Smith and Ranking Member Conyers for this opportunity to present its views on the Marketplace Equity Act of 2011, H.R. 3179, which would allow states to impose tax and tax collection obligations on retailers located outside of those states and that have no physical presence in those states. The bill would grant states the authority to conscript non-citizen businesses to become their tax collectors. These efforts are not federal tax reform—they are not state tax reform. These efforts represent a request from states that Congress impose a 1930's tax regime on 21st Century commerce rather than reforming their tax regimes.

DMA is the leading global trade association of businesses and nonprofit organizations using and supporting direct marketing via channels including mail, telephone, direct TV, radio and the Internet. Founded in 1917, the DMA currently has over 2,000 member companies across the United States and 53 foreign countries.

DMA would like to discuss the history of state efforts to require remote (out-of-state) sellers to become unpaid tax collectors for states, including the Streamlined Sales and Use Tax Agreement (SSUTA), and H.R. 3179.

II. HISTORY: STREAMLINED SALES AND USE TAX AGREEMENT (SSUTA)

The U.S. Supreme Court in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), ruled that without specific authorization from Congress, states could not impose tax collection burdens upon remote sellers that have no "physical presence" as this would interfere with interstate commerce. Moreover, if allowed by Congress, the myriad of state tax jurisdictions with resulting variance in rates, definitions, and audits would create a complex and administratively costly nationwide sales tax collection system. The costs of that collection are a tax on the out-of-state business. It is significant that these remote sellers' businesses do not receive police or fire protection from

those states—they are not present in them. Their employees and their families do not receive educational or social services from those states—the businesses have no employees located in those states.

Governments, as well as businesses, face challenging financial decisions in these economic times. State legislatures have very difficult budget determinations and are looking at both cutting costs and increasing revenues. However, proponents of the SSUTA have cited grossly exaggerated revenue estimates of uncollected sales and use taxes due to remote sales. In particular, proponents have cited a University of Tennessee study conducted in 2000 that includes unbelievable estimates as to the amount of the uncollected sales tax. A revised Tennessee study lowered its initial estimate from $45 billion to $24 billion—even the revised estimates will not be realized.

It is important to note that the Tennessee study rests on a number of faulty assumptions and is not based on U.S. Government data. Further, the study's implication that states are "losing" a substantial portion of their sales tax revenues to electronic commerce is simply false. The vast majority of e-commerce transactions are not with consumers, but rather with businesses, and such business transactions almost always are subject to tax collection or direct payment of use taxes by the purchaser. Moreover, the marketplace is demanding more rapid delivery of purchased goods. To keep those sales, marketers are establishing more and more distribution centers throughout the country establishing nexus under *Quill* in more and more states. The "lost" tax revenue is shrinking—not growing—due to market demand.

In contrast to the Tennessee study, the independent firm, Forrester Research, has estimated that the loss of tax revenue due to state residents not paying use taxes for remote sales is $3 billion nationwide—a fraction of the $24 billion estimated in the revised Tennessee study. A 2007 DMA-commissioned study, based on U.S. Commerce Department data, estimates that in 2006 uncollected sales tax nationally totaled $4.2 billion. A 2010 study by Eisenach-Litan found that uncollected taxes in 2008 totaled $3.9 billion. There is no $24 billion pot of gold.

In light of the *Quill* decision, the states began a project to simplify the sales tax regimes that a remote seller would face if required to become the foreign state's tax collector. The SSUTA goal was to remove that complexity and create a 21st century, Internet-friendly tax regime to encourage economic growth throughout the national marketplace. However, the SSUTA has failed to either remove complexity or create that 21st century tax policy standard. To be blunt, the SSUTA is a document drafted by tax administrators, and, as might be expected, it has resulted in little in the way of tax simplification.

Specifically, the SSUTA:

- Has not reduced the number of sales tax jurisdictions in the Nation, which currently number over 9,600;
- Has not reduced the number of state and local sales tax rates;
- Has not reduced the number of audits to which an interstate seller would be subject (each state revenue department would still conduct its own independent audit);
- Has not established a long-promised uniform vendor compensation to cover the

substantial cost of tax collection; and
- Has not established a single remittance procedure.

Moreover, the Governing Board of SSUTA has granted exceptions to its feeble simplification initiatives to win approval of the states. Recently, the Board granted an exception from the SSUTA-defined rule for Massachusetts when calculating the sales tax on articles of clothing over $100. SSUTA will continue to grant exceptions that will increase the complexity of sales tax collection. States are enacting sales tax holidays—some for all purchases under a capped price; others for specific products (such as hurricane preparedness) on a specific date. Those actions, while important for the state and its citizens, further complicate a nationwide sales tax collection regime.

As you can see, tax collection has not been simplified since the inception of SSUTA. In fact, SSUTA is "streamlined" in name only.

To better appreciate the failings of the SSUTA, it is instructive to consider its history. The Streamlined Sales Tax Project was launched in 2000 on the heels of two earlier joint government/industry initiatives: the National Tax Association (NTA) Communications and Electronic Commerce Tax Project, and the Congressionally-established Advisory Commission on Electronic Commerce. Both projects had concluded that the existing state sales tax system was one of daunting complexity, and that true simplification would require sweeping reforms.

Perhaps most emblematic of the SSUTA's failure to achieve genuine sales tax reform was the early demise of the single-most important step toward simplification: the adoption of a single sales tax rate per state for all commerce (both over-the-counter sales and interstate sales). Had the SSUTA adopted this so-called "one rate per state" proposal, this single act could have eliminated the problem of merchant compliance with thousands of local tax jurisdictions with different tax rates.

To put this "one rate per state" issue in perspective, the United States is the only economically developed country in the world with a system of sub-state transaction taxes, not only for counties and municipalities, but also for school districts, transportation districts, sanitation districts, sports arena districts, and other local jurisdictions. In light of this wildly complex system, the adoption of the "one rate per state" standard was the *unanimous* recommendation of the NTA's E-Commerce Project (which included delegates of the National Conference of State Legislatures, National Governors Association, and US Conference of Mayors) and was in the majority report recommendation of the Congressional Advisory Commission.

Those failings increase the burden on out-of-state sellers. Being subject to 45 separate state audits requires a tax department. Those businesses would be required to have multiple state registrations and multiple remittance procedures. The cost stemming from tax collection would be passed to consumers, constituting an anti-stimulus at a time when our nation is working to stimulate the economy. Moreover, remote sellers with locations only in states that do not impose sales taxes, and that, in turn, have no process in place to collect any sales taxes, would be required to create an entirely new tax department within their company and establish entirely new accounting and ordering protocols. Those remote sellers would face even greater burdens.

Any discussion of tax reform concerning non-citizen companies becoming tax collectors for states, should require tax reform in terms of simplification of state sales tax regimes. Only after that reform should Congress consider granting additional interstate taxing authority to the states with the *proviso* that the tax regime simplification must remain in place.

III. H.R. 3179: THE MARKETPLACE EQUITY ACT

The Marketplace Equity Act attempts to mitigate the significant burden forced sales and use tax collection places upon non-citizens of a state. It fails to reduce the tax burden placed upon remote sellers. The bill grants states three "simplified" alternatives:

- Require collection of a single blended sales tax rate for use in remote commerce; or
- Require collection of the highest sales tax rate in the state exclusive of local tax rates; or
- Require collection of the applicable state and local sales taxes with the state making available adequate computer software to the remote seller and exempting a seller using the software from state liability for incorrect collection.

Experience with the Streamline Sales Tax Agreement indicates that states will choose the latter alternative. States have failed for the past 10 years to reach agreement on single tax rates within a state. With the alternative to require collection for 9,600 tax jurisdictions on the table, that will be the option of choice.

Even the Streamline Sales Tax Agreement calls for states to provide collection software to remote sellers. This represents a cavalier conclusion that providing software is the answer to the tax burden imposed when states conscript non-citizen remote sellers to become their tax collectors (unpaid collectors under H.R. 3179). Tax collection software is not a simple plug-in. Many remote sellers use specialized software for order, fulfillment, billing and inventory control. That software must be up and running 24/7. Adding additional tax collection software cannot cause any down-time for the seller. This adds significant cost to implement any software. Moreover, the tax collection software must be continually updated as states consistently throughout the year tweak their sales tax laws. One Internet based company has testified that the cost to implement sales tax collection in one state cost over $1 million, including work hours. Marketers cannot afford that cost. Thus, the requirement that states make available adequate software does not significantly reduce the burden on interstate commerce notwithstanding what proponents of H.R. 3179 claim. In addition, each state could make available different software—a true administrative nightmare.

H.R. 3179 also fails to address the burden of 46 potential audits (45 states and the District of Columbia). Remote sellers would be required to have a tax audit department and legal counsel at the ready for auditors representing 9,600 taxing jurisdictions. Unlike citizen companies, non-citizen remote sellers would be required to go to courts in states where they have no political voice to resolve any disagreements with state auditors over their tax collection. H.R. 3179 should, at least, repeal the Tax Injunction Act as it applies to disputes on tax collection with non-citizen remote sellers.

H.R. 3179 also fails to address other administrative burdens for non-citizen conscripted tax collectors:

- There is no provision concerning tax holidays that many states have for specific items, such as back-to-school and hurricane preparedness.
- There is no single, uniform rule for sourcing all transactions in a state.
- There is no mechanism to prevent caps and thresholds on taxable items.

The bill does relieve remote sellers from liability of state claims if the seller uses the state "available" software. However, remote sellers are liable for consumer claims (some coming as class action claims) for errors in sales tax collection. H.R. 3179 provides no shield from those claims for remote sellers even when using state "available" software.

The first two alternatives in H.R. 3179, although DMA believes states will not choose them, create for the first time a different legal sales tax rate for remote sales *vis-à-vis* retail sales. Although today non-citizen remote sellers are not required to collect sales tax, the consumer is liable for that tax—the same tax that is applied to retail sales in the consumer's jurisdiction. H.R. 3179 would create a different tax rate—some higher than the retail tax rate and some lower. To DMA's knowledge, this is a first—with its own legal considerations.

H.R. 3179 assumes that the seller calculates the tax for the consumer and includes the tax in the amount charged. DMA has many members whose customers still pay by check and calculate the shipping and would calculate the sales tax themselves. In practice it is impossible for a remote seller to provide the check payer (who likely orders *via* the U.S. Mail) with the tax rates for 9,600 jurisdictions. Moreover, when faced with an incorrectly calculated tax on a check order, the seller faced with an overpayment must either provide a refund or credit and contact the customer with that information and choice which is very costly. With an underpayment of tax the seller is faced with an even more difficult and costly choice. The seller may hold the order and request further payment from the customer or may simple pay the additional tax itself (a new tax burden). DMA knows of a company located in a state with numerous local sales tax rates that simply asks consumers paying by check to remit the state sales tax and it pays the local sales tax to avoid customer confusion. Administrative burden is not washed away by computer software.

The Marketplace Equity Act does not provide for any compensation for non-citizen remote sellers. Passage of the Act would eliminate any further discussion on compensation. It is important to remember that these sellers are non-citizens of the state and are being conscripted to become tax collectors for that state. Compensation would be one facet of equity.

IV. CONCLUSION

The bright-line physical presence test in *Quill* should remain for collection of sales and use taxes without significant simplification reform of state sales tax regimes. The burden of each on interstate commerce is large, and this is a time when our economy can ill afford such a burden.

DMA urges Congress both to uphold the physical nexus standard of *Quill* rather than extending taxing authority of states to include the collection of sales and use tax beyond their borders without significant simplification reform by the states.

Written Testimony of the
Electronic Retailing Association

Before the
United States House of Representatives
Committee on the Judiciary
Hearing on
Marketplace Equity Act of 2011

July 24, 2012

Bill McClellan
Vice President, Government Affairs
Electronic Retailing Association
607 14th Street, NW
Suite 530
Washington, DC 20005
703.908.1032

Introduction

Chairman Smith, Ranking Member Conyers and Members of the Committee, the Electronic Retailing Association ("ERA") thanks you for the opportunity to submit this written testimony on the impact of remote sales tax policies for electronic retailers. We believe that the Marketplace Equity Act of 2011, H.R. 3179, would significantly harm American businesses, their employees and the customers who rely on a healthy and vibrant marketplace. Forcing remote sellers to collect and remit sales tax in jurisdictions in which they do not have physical presence or "nexus" will create a new tax burden resulting in considerable economic harm. It is our view that new and misguided remote tax schemes will materially affect electronic retailers working to survive in these harsh economic times. Massive cost increases and new regulatory burdens will result damaging consumers and the marketplace on which they rely. ERA urges you to protect electronic retailers, both large and small, from this new tax burden and continue supporting entrepreneurial efforts that create jobs and help stabilize the economy.

The Electronic Retailing Association is the trade association in the U.S. and internationally that represents leaders of the direct-to-consumer marketplace, which includes members that utilize electronic retailing on television and online to engage with consumers. Today, ERA proudly represents more than 450 companies in 45 countries including many of the industry's most prominent retail merchants. ERA's membership consists of a diverse ecosystem of businesses and entrepreneurs operating at the cutting edge of innovation who have adapted to the rapidly evolving challenges found in the current retail landscape.

Background

For decades state governments have wrestled with the challenges of collecting sales and use tax on purchases for out-of-state retailers. What began with mail-order catalogs and telephone orders has increasingly moved online and now state collectors are blaming online commerce for uncollected sales taxes and the decline of Main Street businesses. But the tax loss numbers do not add-up. Main Street retailers use remote selling techniques to compete with mass "brick and mortar" retailers, and upon second glance proposals to simplify tax systems is not so simple and create a new tax burden for affected remote sellers.

The Streamlined Sales Tax Project (SSTP) began in response to the 1992 U.S. Supreme Court decision *Quill Corp. v. North Dakota*, 504 U.S. 298 for a catalog business that sold office supplies – long before the modern era of online commerce. This ruling affirmed a 1967 Supreme Court decision *National Bellas Hess v. Department of Revenue, 386* U.S. 753 that state sales tax systems are so complex that no retailer – whether storefront, catalog, or online – should have to collect sales tax for states where they have no physical presence or "nexus". The new tax burden of compliance would be too high. That left the states with two options – radically simplify sales tax systems and come back to the Courts for another look, or persuade Congress to force remote retailers to collect sales taxes, whether the systems are simple or not. States pleading for more taxing authority as the first dot-com bubble expanded, and then cried louder as the U.S. economy slowed and spending by states outpaced revenues. State tax officials blamed online commerce for their fiscal problems based on forecasts of growth in e-commerce. A short time later state sales tax revenue had recovered. Despite minimal progress in simplifying sales tax systems again Congress finds itself petitioned to impose new tax burdens on remote sellers as state tax coffers run low.

The Numbers

States, "brick and mortar" retailers and other advocates of the Streamlined Sales Tax Project (SSTP) continue to use estimates that just don't add up. They cite a University of Tennessee study that blames online commerce for $24 billion in lost sales tax revenue a drastic reduction from the study's prior estimate of $45 billion in 2000. An independent review from Forrester Research estimates that unrealized revenue from uncollected sales tax equates to $3 billion nationwide. Similarly, the Direct Marketing Association (DMA) conducted a study in 2006 based upon U.S. Commerce Department data that supports this level finding that the total amount of uncollected sales tax nationwide totaled $4.2 billion. Even if none of that sales tax were collected, the loss would be significantly less than the Tennessee estimates. Despite these findings proponents of SSTP continue to cite questionable estimates from the University of Tennessee study. As Congress debates this issue, it is clearly in the public interest that an accurate portrayal of estimates are provided as members conduct their cost benefit analysis and weigh imposing a new tax burden upon remote sellers.

The Facts

Remote Retailers Collect Sales Tax Today. All online sales already are subject to tax. All retailers whether "brick and mortar" or remote retailer are required to collect sales tax on goods delivered in any state where the retailer has a physical presence or "nexus". Consumers are obligated to pay a "use tax" on all purchases even if the seller is not required to collect the sales tax. States have done little to educate consumers about their use tax obligation or to provide them with any easy way to comply.

New Tax Burdens would harm American Business. Tax collection under this new taxing scheme would cause thousands of American businesses to be confronted with entirely new tax obligations of collecting and remitting taxes for over 9,600 taxing jurisdictions throughout the country. This new tax burden would include school districts, transportation districts, sanitation districts and sports arena districts among others. This will dramatically increases the complexity of remote commerce as a viable medium for business activity. State tax collectors have failed in their original mission to reduce the number of tax jurisdictions. Similarly, State tax collectors have failed to reach its goal of uniform definitions for taxable products. Instead, each state is allowed to create its own "gray area" with respect to every term defined in the Agreement. Individual states only have to use "substantially the same language" a recipe for confusion and litigation from businesses forced to comply with this new tax burden. For consumers, the confusion and complexity are even more problematic. Shoppers who pay by check for catalog purchases (a common form of payment among the elderly and low income wage earners) must self-compute the applicable state and local sales tax for each jurisdiction to which a mail order purchase is sent. Again, these are major new tax burdens – not simplification.

The inability of "brick and mortar" big box retailers to compete is overstated. Often "brick and mortar" retailers imply that e-commerce is hurting their business and they cannot compete. Nothing could be further from reality. Despite collecting sales tax for online purchases "brick and mortar" retailers dominate the Internet Retailer Top 500 List of the most successful online retail businesses. The reality is for decades small retailers (online and off) have lost sales to big-box stores. In recent years, the Internet has offered the best hope for success of Main Street retailers to compete.

Efforts to enact online sales tax collection by "big box" retailers represent an attempt to alter the playing field in their favor by unfairly discriminating against remote sellers. Online, burdens are much greater for remote sellers who must compute, collect and remit tax for thousands of jurisdictions, as compared to an in-state retailer who collects at just one tax rate. Remote retailers are also responsible for the difference if a customer fails to remit the correct tax when paying by check – a problem that traditional retailers do not confront. Delivery charges usually exceed the amount of sales tax on those same goods – leaving remote sellers with no price advantage over their "brick and mortar" peers. Competitive claims aside, the evidence clearly show that "brick and mortar" big box retailers enjoy an overwhelming advantage both online and off for the foreseeable future.

Conclusion

The Electronic Retailing Association strongly contests efforts to force a new tax burden upon electronic retailers called for by the Marketplace Equity Act (H.R. 3179). While the bill grants states three "simplified" alternatives industry experience with the Streamlined Sales Tax Agreement dictate that states will opt to require collection of the applicable state and local sales taxes with the state making available adequate computer software to the remote seller. This system does not currently exist in the marketplace today. Nor can software been seen as a simple fix as all electronic retailers use specialized software for order, fulfillment, billing and inventory control. The chilling effects of software as a "magic" solution cannot be overstated. One Internet based company recently testified that integrating its systems cost $1 million for one state alone. This new tax burden alone would force many members of the Electronic Retailing Association out of business.

While the bill does relieve remote sellers from liability of state claims if the state's "available" software is used it does not address remote seller liability from class action claims for errors in sales tax collection nor address the new tax burden of 46 potential audits for the 9,600 taxing jurisdictions. These new tax burdens will require Electronic Retailers to maintain both tax audit services as well as substantial legal resources to respond to issues as they arise.

Therefore we believe that H.R. 3179 will devastate electronic retailers working to survive in these harsh economic times. A growing number of industry participants tell us that in recent years they have seen a decrease of up to 40% in their sales and that the worst affected are "hanging by a thread." Participants also report being grateful that they have survived the recent economic downturn. Enactment of H.R. 3179 would call into question their survival with new regulatory requirements and new tax burdens. We urge you to support Electronic Retailers as the industry recovers and resist the urge to hamper budding entrepreneurial efforts to create good jobs that help stabilize the economy.

July 20, 2012

The Honorable John Campbell
1507 Longworth Building
Washington, DC 20515

Congressman Campbell:

As the Marketplace Equity Act of 2011 (HR 3179) moves to committee this week, all of us need to be aware of not only what the bill is intended to do, but of the dire consequences that will result from its enactment.

Proponents of the bill claim the issue is one of fairness; by closing the on-line tax loopholes, and eliminating the competitive disadvantages of "brick and mortar" retailers vs. on-line marketers. They further claim, this bill was initiated in the best interest of the "consumer". From our perspective, this could not be farther from the truth.

It is not my intention to impugn the bill or any of its facets, but rather demonstrate how it will adversely affect our firm, as well as, thousands of other small businesses in America.

The compliance requirements of the bill represent a significant burden to our business. Firstly, we would be required to build an "infrastructure" to support the collection/reporting/payment of sales taxes for hundreds of jurisdictions. This will require us spend thousands of dollars modifying our websites, media programming, literature, and marketing materials for compliance. Placing this liability on small business in this challenging economic climate, exemplifies ignorance.

Realistically, small business cannot afford to absorb these additional liabilities. They would, in turn be passed down to consumers, in the form of higher product costs. Doing so, would not only reduce the purchasing power of the consumer, the net effect to our business would be reduced revenues, lower profits, and increased unemployment. As a result, any reduction in small business revenues would reduce the sales tax this bill is intended to stimulate.

Secondly, this bill represents a challenge (not only to small business) but to State Tax Agencies. These agencies, are not yet prepared to administer this mandate, having yet to define a consistent format and/or program (nationwide) for this reporting. By "putting the cart in front of the horse", we (collectively, as small businesses) would be subjected to a bureaucratic nightmare of overwhelming

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USA

proportion, while each agency decides how to respond to this bill. Every change and/or regulation represents an additional expense to the business person seeking compliance. In effect, we would be a "beta" test site to 45+ agencies, "jumping through hoops" with no end in sight to possible complications and/or expenses.

Over the past 2 years, segments of our industry have seen upwards of a 40% reduction in revenues, and an equivalent reduction in employment. Most of us consider ourselves "lucky" to remain in business, much less "profitable". But, I don't need to tell you the last several years have been difficult for small businesses nationwide. With the challenges of rising costs and receding revenues, we cannot afford legislation that represents an affront to the viability of our businesses.

ALL of us at BJ Global Direct, look for your leadership to adamantly oppose this bill and/or any similar legislation that would harm/jeopardize America's small businesses. If I can be of personal assistance to you in this effort, please feel free to contact me directly.

Respectfully,

Bizhan Fazeli
President
BJ Global Direct, Inc.

On Behalf of Mr. Bizhan Fazeli

Phone: 949.753.1111 Fax: 949.753.1111 www.bjglobaldirect.com 8645 Research Drive, Irvine, CA 92618
USA

July 24, 2012

The Honorable Lamar Smith
Chairman
Committee on the Judiciary
United States House of Representatives
2138 Rayburn House Office Building
Washington, DC 20515

The Honorable John Conyers
Ranking Member
Committee on the Judiciary
United States House of Representatives
2138 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Smith and Ranking Member Conyers:

We, the undersigned organizations, write to express our strong opposition to H.R. 3179, the Marketplace Equity Act, which would impose significant cost burdens on Internet-enabled businesses across the nation.

If enacted, this bill would overturn the Supreme Court's decision in the *Quill* case and allow a group of states to impose new and onerous tax burdens on Internet-enabled retailers and entrepreneurs that do not reside in their states. Not only will this give a group of state governments far-reaching and ground-breaking tax collection authority, but it will also undoubtedly impede the growth and development of interstate commerce.

Over the past decade, Internet-enabled businesses and entrepreneurs have become an integral part of our nation's economy and have produced hundreds of thousands of jobs. There is no doubt that the Internet has been an engine for innovation, empowerment and economic development, especially in the world of retail. The Internet has connected entrepreneurs across America, including individuals in rural and disadvantaged communities, with consumers in every corner of the world. This "global market" has provided businesses the opportunities to grow and expand and has enabled consumers to access quality goods and services.

At a time when our nation is recovering from challenging economic times, we believe Congress should be enacting pro-growth policies that encourage and increase economic activity, not increase costs and burdens on our nation's businesses. We also feel that H.R. 3179 does not adequately address several of the discriminatory actions surrounding interstate taxation that directly affect innovation, such as business activity and the disparate treatment of digital offerings. The new burdens that H.R. 3179 would impose on our nation's online entrepreneurs will not only adversely impact hundreds of thousands of jobs, but would undermine the robust e-commerce market that consumers across the world currently enjoy.

We appreciate your consideration.

Sincerely,

Computer & Communications Industry Association
Direct Marketing Association, Inc.
Electronic Retailing Association
Information Technology Industry Council
NetChoice
TechAmerica
TechNet

July 23, 2012

The Honorable Lamar Smith
Chairman
Committee on the Judiciary
U.S. House of Representatives
Washington, DC 20515

The Honorable John Conyers
Ranking Member
Committee on the Judiciary
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Smith and Ranking Member Conyers:

On behalf of the organizations listed above representing our nation's cities, towns and counties, we appreciate the opportunity to submit the following comments on the *Marketplace Equity Act (H.R. 3179)*, which will assure a simpler system of taxation and help our members recover tax revenues that are due from purchases made by remote means. The *Marketplace Equity Act* does not impose a new tax, but would provide states and localities with a mechanism to require the collection of sales and use taxes on Internet and mail-order sales. This would help to level the playing field between those remote sellers and brick and mortar stores on Main Street.

While the increasing strength of electronic commerce creates exciting new marketplaces, it has also put traditional retail outlets at an unfair disadvantage because of outdated and inequitable tax and regulatory environments. The Supreme Court's decision in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), left state and local governments unable to adequately enforce their existing sales tax laws on sales by out-of-state catalog and online sellers. But Congress, with its clear constitutional authority to regulate interstate commerce, can give states and local governments the option to require sellers who do not have a physical presence in their jurisdiction to charge and collect sales taxes from their customers.

The *Marketplace Equity Act* would give state and local governments the option to collect the sales taxes that are already owed under current law from out-of-state businesses, rather than rely on customers to pay those taxes to the states when filing their annual state tax returns. While brick-and-mortar retailers directly collect sales taxes from customers who make purchases in their stores, many online and catalog retailers do not collect these same taxes. This puts main street retailers at a five to ten percent competitive price disadvantage to remote sellers. It is significant to note that customers are already required to pay taxes when they make online purchases, just like when they make purchases in a store; however, most taxpayers are not aware of this responsibility, and states and localities do not have the resources to enforce payment.

We note, however, two concerns with the *Marketplace Equity Act*. First, as introduced, the legislation allows states to exclude local sales and use taxes from being collected. This is done in Section 4 (A)(i) and (ii), by allowing states to administer a tax system on remote sales that would use a single tax rate for the entire state or a blended rate, rather than the third option that

July 23, 2012
Page 2

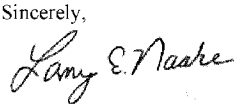
preserves local sales and use taxes. Both the single and blended rate options would pre-empt local sales and use tax statutes by not allowing the full sales tax rate to be collected on remote sales. This would obviously undermine the legislation's objective to develop an equal playing field for all sales, as one (lower) tax could be charged for remote sales through a single or blended tax rate, and another (higher) tax, which includes the state and full local sales tax rate, would be collected on sales made in physical stores. We respectfully suggest the *Marketplace Equity Act* be amended to preserve the ability of local governments to maintain their own tax rates, and impose that same tax rate on both remote and brick and mortar sales.

We would like the bill to also recognize the important and longstanding Streamlined Sales and Use Tax Agreement that twenty-four states have adopted. The Agreement provides important administrative, definitional and procedural guidance for states and retailers alike to follow, and should be relied upon as the legislation hopefully becomes law and is implemented at the state level.

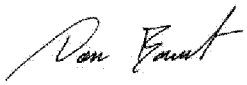
There is no time better than now for this legislation to move forward, as local governments face the fifth straight year of declines in revenue with probable further declines in 2013. We look forward to working with Representative Womack and other Congressional leaders to address the concerns of local governments, and support efforts to enact sales and use tax simplification.

Thank you again for the Committee's attention to this hearing.

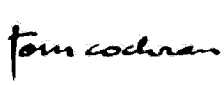
Sincerely,



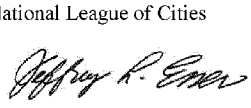
Larry E. Naake, Executive Director
National Association of Counties



Donald J. Borut, Executive Director
National League of Cities



Tom Cochran, CEO and Executive Director
United States Conference of Mayors



Jeffrey L. Esser, Executive Director and
CEO Government Finance Officers
Association

Submission of the National Retail Federation

to the

House Committee on the Judiciary

Hearing on H.R. 3179, the "Marketplace Equity Act of 2011"

July 24, 2012

David French
Senior Vice President, Government Relations

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As the world's largest retail trade association and the voice of retail worldwide, NRF represents retailers of all types and sizes, including chain restaurants and industry partners, from the United States and more than 45 countries abroad. Retailers operate more than 3.6 million U.S. establishments that support one in four U.S. jobs – 42 million working Americans. Contributing $2.5 trillion to annual GDP, retail is a daily barometer for the nation's economy. NRF's Retail Means Jobs campaign emphasizes the economic importance of retail and encourages policymakers to support a Jobs, Innovation and Consumer Value Agenda aimed at boosting economic growth and job creation. www.nrf.com

Summary of Comments

Members of the National Retail Federation believe that Congress must resolve the Constitutional questions posed by the *Quill* decision in a fashion which promotes a level playing field among retail competitors. As retailing evolves and Internet sales become a more prominent portion of total retail sales, it is critical that Congress support pro-small business reform of a broken sales and use tax collection system.

Brick-and-mortar retailers compete vigorously with each other and with remote retailers for market share. Different retailers have different strategies for going to market, but one feature is beyond a retailer's control: only some competitors are compelled by the government to collect sales taxes. This situation is not created by the marketplace, but rather it is a disadvantage imposed by the current state of the law following the *Quill* decision, stifling retailers across the country.

In addition to the perceived pricing disadvantage caused by sales tax being included in the cost of the purchase from the brick-and-mortar store, local stores also bear a significant compliance burden for collecting the tax. Compliance costs for small retailers are high, placing them at more of a competitive disadvantage.[1]

Simplification is a key component for reform of the sales tax collection system for both brick-and-mortar sellers and remote sellers who voluntarily collect sales tax. Many members of the NRF voluntarily collect sales tax on remote sales into states where they do not have a physical presence. In many instances, the retailers that voluntarily collect sales tax do so only from states that have adopted the Streamlined Sales and Use Tax Agreement ("SSUTA") because of the Agreement's simplified collection requirements.

Granting states the authority to collect sales tax from remote sellers will add significant resources to state budgets to support essential local services including teachers, police officers, firefighters and ambulance crews and reduce pressure to seek alternative sources of revenue from already burdened businesses within their borders. Remote sales include e-commerce, mail order sales, telephone orders, and deliveries made across state lines. By 2012, total e-commerce sales are estimated to reach $4 trillion dollars.[2] Annual national state and local sales tax losses on e-

[1] PricewaterhouseCoopers LLP, *Retail Sales Tax Compliance Costs: A National Estimate Volume One: Main Report*, April 2006. That study defined "small retailers" as having less than $1 million in annual retail sales.
[2] Donald Bruce, William F. Fox, and LeAnn Luna, *State and Local Government Sales Tax Revenue Losses from Electronic Commerce*, University of Tennessee, April 2009, available at http://cber.utk.edu/ecomm/ecom0409.pdf.

commerce alone are conservatively expected to grow to $23.3 billion by 2012 for a six-year total loss of $52 billion.[3]

NRF is encouraged by this Committee's interest in this issue as well as the several legislative proposals that have been introduced this Congress to address sales tax fairness, including the Marketplace Equity Act, H.R. 3179, introduced by Representatives Womack and Representative Speier. NRF supports Congress granting states remote collection authority with simplifications that ensure all retailers are not unduly burdened by collecting and remitting sales taxes.

The Impact of *Quill* on Small Local Retailers

The current sales tax collection system ignores the realities of how today's technology driven economy hurts local small businesses.[4] No matter how local retailers refine their business model, they cannot decrease the amount of sales tax they are legally required to collect from their customers. This places small local retailers at a competitive disadvantage if certain remote sellers are allowed to escape from this requirement. This competitive disadvantage must be cured with Congressional action.

A sales tax is a tax on the consumer and is imposed where the consumption or use takes place. Alternatively, the use tax is assessed by a state for use, storage, or consumption of goods when a sales tax is not collected. So all sales in a given state are subject to the sales or use tax, regardless of whether the sale occurs in a store in the state or in the home of a resident of the state through their computer or telephone.

If Congress permits the state to only collect the sales tax on sales that occur in stores in that state and not sales made online in that state, then Congress is creating an unlevel playing field to the disadvantage of local stores in congressional districts. Given the rise in online sales, continuation of this system will create such an unfair burden on those consumers that actually pay taxes due that states will have to move away from sales tax systems and find other sources of revenue (e.g. more reliance on income taxes).

A federal solution to the *Quill* decision will allow states to broaden the base and apply their taxes equally to all items sold promoting an efficient sales tax system. Allowing states to capture remote sales tax revenue equitably regardless of a retailer's business model is meaningful pro-small business reform of a broken collection system. This reform is necessary to reduce the uncertainty currently rampant as shown by state-by-state attempts to establish nexus for collection purposes artificially stifling the growth and expansion of small and medium sized businesses across the country.[5]

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[3] "Collecting E-Commerce Taxes" National Conference of State Legislatures, available at http://www.ncsl.org/issues-research/budget/collecting-e-commerce-taxes-an-interactive-map.aspx (last accessed July 23, 2012).

[4] "The time has come for sales tax fairness: Hear Their Stories," July 2012, available at www.retailmeansjobs.com/salestaxfairness/stories (last accessed July 23, 2012).

[5] *See* Jordan King & Joseph Henchman "Scholastic Books Faces State Tax Overreaching" May 15, 2012, Tax Foundation, available at http://taxfoundation.org/article/scholastic-books-faces-state-tax-overreaching (last accessed July 23, 2012)

The Effect of Simplification on All Retailers

Simplification of the current sales tax system will reduce the burdens highlighted in the *Quill* decision and benefit all retailers.[6] Through adoption of the SSUTA, 24 states have already implemented significant simplification of their sales tax laws for all retailers. This simplification has incentivized collection of sales tax by many remote sellers that currently are not required to collect sales taxes. Many regional retailers with significant national business through their Internet channels collect sales tax on remote sales but only in states that have adopted the SSUTA.

Collecting sales taxes from all retailers is a more efficient approach to dealing with the realities of e-commerce's constantly evolving business model. However, small businesses' good faith effort to collect sales tax will be undermined by a grant of collection authority to the states that does not include simplification steps and liability protection. Technology allows for meaningful simplification in a way that was not possible at the time *Quill* was decided. In fact, groups who argue against reform in this area acknowledge that simplification through technology is possible. The combination of software solutions and liability protection recognizes the collection challenges for all retailers and reduces burdens imposed by the state.

While NRF believes that a modest small seller exemption for remote sales is appropriate, raising the level too high will only exacerbate the potential for inequity between a small remote retailer that does not have to collect any taxes and a local small retail competitor who must collect sales taxes on the first dollar of sales. Congress should resist the temptation to envision that a small seller exemption is the easy answer to meaningful small business regulatory relief.

Background

In 1992, the U.S. Supreme Court ruled in *Quill v. North Dakota* that "remote sellers" — a category that includes mail-order, telephone and Internet merchants — cannot be required to collect sales tax from customers in states where the merchant does not have a physical presence or "nexus." The court reasoned that the sales tax system was too complex for a merchant to know what sales tax to charge an out-of-state customer — 45 states and 7,600 local jurisdictions collect sales tax, each with its own rates, lists of taxable items and definitions of taxable items. But the justices suggested that sales tax collection could be required if the system were simplified and Congress authorized the collection authority because remote sellers are "purposely availing" themselves to a jurisdiction's authority by engaging in commerce.

In late 1999, in response to the Supreme Court ruling, states and the business community, including NRF, began the Streamlined Sales Tax Project, with an aim toward significant simplification of state sales tax systems. Since then, a baseline multi-state agreement, the SSUTA, which includes common definitions, uniform processes and procedures, and significantly simplified administrative features has been passed by 24 states (21 full member states and 3 associate member states), establishing the necessary groundwork for action by Congress. The 21 full member states with voting rights include: Arkansas, Iowa, Indiana,

[6] The compliance costs for retailers responsible for sales tax collection without simplification is detailed in the submission of the National Retail Federation to this Committee's hearing on November 30, 2011 entitled "Hearing on Constitutional Limitations on States' Authority to Collect Sales Taxes in E-Commerce."

Georgia, Kansas, Kentucky, Michigan, Minnesota, Nebraska, Nevada, New Jersey, North Carolina, North Dakota, Oklahoma, Rhode Island, South Dakota, Vermont, Washington, West Virginia, Wisconsin and Wyoming. Three associate member states with negotiating authority but delayed voting rights are Ohio, Tennessee and Utah. Utah was recently granted full Member State status effective October 1, 2012.[7] Delegates from the 24 states administer the SSUTA through the Streamlined Sales Tax Governing Board.

As electronic commerce continues to grow, so will the losses to state and local revenues.[8] In fiscal year 2012, it is conservatively estimated that state and local governments stand to lose at least $23.2 billion in uncollected sales and use taxes from remote transactions, with over $11.6 billion uncollected from e-commerce transactions.[9] General sales taxes make up roughly one third of state tax revenue.[10] Sales tax is primarily collected by the retail industry, and the retail industry continues to bear the compliance burden for this critical portion of state and local government budgets.[11]

Current Sales Tax Fairness Legislation before Congress

The two leading bills introduced this Congress to address the issue of sales tax fairness are the Marketplace Fairness Act and the Marketplace Equity Act.

(1) Marketplace Equity Act of 2011, H.R. 3179, sponsored by Representatives Womack and Speier allows states to collect sales taxes from remote sellers if they meet three minimum simplification requirements. These three simplification requirements may be met in an interstate agreement, presumably including the SSUTA. Sellers with less than $1 million in remote U.S. sales or $100,000 in remote sales into a particular state are exempted. The three simplification steps are: (1) a single revenue authority within a state for submission of a return; (2) a single tax base set by the state; and (3) the state must choose a single tax rate from three choices: a blended rate of state and locality rates, the maximum state rate, or the destination rate.

(2) Marketplace Fairness Act of 2011, S.1832, sponsored by Senators Enzi, Durbin, Alexander and Tim Johnson provides a path for states to collect sales tax that incorporates a combination of either nine simplification steps or adoption of the SSUTA. The Marketplace Fairness Act exempts remote sellers with less than $500,000 in remote U.S. sales, requires a single audit by states and localities within a state, requires a single state tax rate based on the destination of the sale, states must

[7] Press Release, "Utah Accepted as Full Member State." Streamlined Sales and Use Tax Governing Board, Inc. June 27, 2012, available at http://www.streamlinedsalestax.org/index.php?mact=News,cntnt01,detail,0&cntnt01articleid=127&cntnt01origid=15&cntnt01returnid=74 (last accessed July 23, 2012).
[8] Donald Bruce, William F. Fox, and LeAnn Luna, *State and Local Government Sales Tax Revenue Losses from Electronic Commerce*, University of Tennessee, April 2009, available at http://cber.utk.edu/ecomm/ecom0409.pdf.
[9] *Id.*
[10] Lucy Dadayan and Robert B. Ward, *State Revenue Report*, The Nelson A. Rockefeller Institute of Government, Oct. 2011, No. 85, available at http://www.rockinst.org/pdf/government_finance/state_revenue_report/2011-10-26-SRR_85.pdf.
[11] PricewaterhouseCoopers LLP, *Retail Sales Tax Compliance Costs: A National Estimate Volume One: Main Report*, April 2006, available at http://www.bacssuta.org/Cost%20of%20Collection%20Study%20-%20SSTP.pdf.

establish certification procedures for software and service providers (to calculate rates), and gives remote sellers liability protection for relying on incorrect information supplied by service providers.

Each bill grants states the authority to require remote sellers to collect sales tax on transactions into their respective state if simplification steps are adopted. The varying simplification requirements include tax base, tax rate, and collection software requirements.

Conclusion

The National Retail Federation has long supported sales tax fairness legislation, and we are encouraged by the momentum that is building toward a solution. We look forward to working with the Committee on legislation to ensure effective and fair sales tax collection while relieving burdens placed on a growing sector of the economy.

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The Honorable John Conyers
US House of Representatives
2408 Rayburn House Office Building
Washington DC 20515

July 19, 2012

Dear Congressman Conyers:

It is our understanding that the House Judiciary Committee is holding a hearing July 24, 2012 to discuss overturning a twice-vetted Supreme Court decision (1967's *National Bellas Hess* ruling and 1992's *Quill* decision that upheld the 1967 law) that holds the imposition of chaotic state and local sales taxes constitute a significant barrier to interstate commerce. This Constitutionally-protected right is what enables our national economy to g row.

Our company provides web hosted services to marketers across the country for the purpose of managing their customers and orders acquired in their direct to consumer business environments. While we offer the technology to facilitate the collection and tracking sales tax, it is generally used to collect taxes within the states that the marketer is doing business in and the purchaser resides in. We enjoy a strong client base but I can tell you that we serve a very small percent of direct to consumer businesses. The majority of these businesses are too small to be able to afford the type of services that we, and other service providers, offer. If these smaller retailers had to comply with guidelines envisioned in H.R. 3179, many would either be out of business or in violation of the law.

The implied expectation that these smaller businesses should be expected to become tax collecting agents for 45 plus states and an additional 9,000 to 10,000 taxing jurisdictions are well beyond reason. The administrative task of remaining current with all the tax rates and rules, prepare and submit filings, coupled with the need to respond to possible legal actions and audits would simply drive many of the companies out of business.

We would like to register our strong opposition to H.R. 3179 in its current form. We think there are sound policy reasons to preserve the status quo, but even if you choose to change the *Quill* decision, we urge you to write safeguards into statute so small- and medium-sized businesses can cope with the complexity this brings.

We believe that this will simply shift a burden onto the small business community that is already struggling to survive in a weak economy. This is not the answer to rebuilding a stronger America. In fact, in its current form, this bill would drive a stake through the heart of the American entrepreneur and put more people out of work.

Thank you for your urgent consideration of this matter.

Sincerely,

William Southwick
V P of Sales & Marketing
OrderLogix

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PO Box 6798 • Scarborough, ME 04070

LEE TERRY
NEBRASKA, 2ND DISTRICT

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WASHINGTON, DC 20515
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Congress of the United States
House of Representatives

HOUSE COMMITTEE ON
ENERGY AND COMMERCE
SUBCOMMITTEES:
COMMERCE, TRADE AND
CONSUMER PROTECTION
ENVIRONMENT AND HAZARDOUS
MATERIALS
COMMUNICATIONS, TECHNOLOGY
AND THE INTERNET
REPUBLICAN DEPUTY WHIP
REPUBLICAN POLICY COMMITTEE
REPUBLICAN STEERING COMMITTEE

July 25, 2012

The Honorable Lamar Smith
Chairman
Committee on the Judiciary
2138 Rayburn House Office Building

Dear Chairman Smith,

I recently received the attached correspondence from a business located in my District and wanted to share it with you and your staff.

We know all to well the burdens placed on our nations businesses today by the overreach of the federal government and as such, I would caution our leadership from moving a bill that could increase costs, cause sales loss and ultimately lead to lost jobs.

At a time when our fragile economy needs all the help it can get, I ask that you consider the following concerns raised by my constituent regarding the Marketplace Equity Act.

Sincerely,

Lee Terry
Member of Congress

Enclosed:
7/20/12 Oriental Trading Company, Inc.

GENERAL COUNSEL'S OFFICE
Telefax: (402) 829-4489

July 20, 2012

The Honorable Lee Terry
2331 Rayburn House Office Bldg.
Washington, DC 20515-2702

Dear Representative Terry:

We understand that the House Judiciary Committee is holding a hearing on July 24, 2012 on H.R. 3179, the "Marketplace Equity Act." We are concerned that this bill has not been well thought out, will have disastrous unintended consequences and is being deceptively promoted as a way to achieve "fairness" and solve state tax collection problems.

First, the bill purports to require non-Streamlined Sales Tax Agreement states to adopt "minimum simplification requirements." However, there are no clear standards as to what these simplification requirements mean or how they must be met, and no oversight to ensure such simplification is done. As a result, the bill virtually ensures litigation.

Second, such "simplification" does nothing to resolve the patchwork of existing state tax laws and, in fact, may make it worse with each state enacting its own measure of "simplification". Rather than allow states to export the complexity of their sales tax laws, Congress should require them to first reform their tax systems before even considering granting authority to impose tax collection obligations on out of state retailers.

Finally, the burdens that this bill will impose are enormous. It is not as simple as just installing some software. Software must be integrated with order, fulfillment and inventory systems. Moreover, our business, for example, carries more than 30,000 different items. Integration of tax collection software will require manual data input and maintenance to ensure proper designation of whether each item is taxable or not and at what tax rate in each of more than 9,600 taxing jurisdictions. That is a costly burden that bricks and mortar retailers don't have.

H.R. 3179 will result in increased costs, lost sales, and lost jobs. It will increase regulatory burdens on small and medium sized businesses which can ill-afford it.

Those are among the reasons why we oppose H.R. 3179 in its current form. We urge you to not support that bill.

If we can be of assistance to answer questions you may have, please do not hesitate to contact me.

Very truly yours,

ROBERT R. SIEFRING
General Counsel

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July 23, 2012

The Honorable Lamar Smith
Chairman
Judiciary Committee
U.S. House of Representatives
Washington, D.C. 20515

The Honorable John Conyers
Ranking Member
Judiciary Committee
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Smith and Ranking Member Conyers:

On behalf of the Retail Industry Leaders Association (RILA), we commend the Judiciary Committee for holding a legislative hearing this week on H.R. 317, the Marketplace Equity Act, which is of the utmost importance to the retail industry as well as many other stakeholder groups. The bipartisan Marketplace Equity Act corrects a critical flaw in our state taxation policies that today puts brick and mortar stores at a competitive disadvantage to online-only companies that aren't required to collect state sales taxes. RILA hopes that after this week's legislative hearing on the Marketplace Equity Act that all remaining issues can be addressed and that the Committee will be able to move forward on the legislation in short order.

By way of background, RILA is the trade association of the world's largest and most innovative retail companies. RILA promotes consumer choice and economic freedom through public policy and industry operational excellence. Its members include more than 200 retailers, product manufacturers, and service suppliers, which together account for more than $1.5 trillion in annual sales, millions of American jobs and operate more than 100,000 stores, manufacturing facilities and distribution centers domestically and abroad.

At issue is a decades-old loophole that requires that brick and mortar retailers collect sales taxes if they have a physical presence in a state, while online-only companies aren't held to the same standard. This policy has the effect of putting local brick and mortar stores who take the time to build a store, hire locally, contribute to the community, and pay property taxes at a 5-10% competitive disadvantage on price. Tax policy that treats two competitors differently is inherently unfair, and the Marketplace Equity Act before this Committee takes a reasonable approach toward leveling the playing field while providing protection for small businesses and requiring states to simplify their collection requirements on remote sellers. This is not a new tax, nor a tax on remote sellers: it is simply a question of whether all types of business will collect, on behalf of the consumer, a tax that is already owed.

In closing, RILA appreciates that the Judiciary Committee is giving the issue of e-fairness and the Marketplace Equity Act the appropriate attention it deserves. The growing bipartisan support for e-fairness legislation over

the past few months has become evident, with governors, editorial boards and businesses all calling on Congress to take action this year. RILA urges the Committee to favorably report the Marketplace Equity Act so that the government gets out of the business of picking winners and losers in the marketplace, and so that our members can get back to the business of serving our customers and helping to grow the economy.

Sincerely,

Bill Hughes
Senior Vice President, Government Affairs

Cc: Members of the House Judiciary Committee

Software Finance & Tax Executives Council

www.softwarefinance.org

July 24, 2012

Via Email

Hon. Lamar Smith
Chairman
Hon. John Conyers, Jr.
Ranking Member
Committee on the Judiciary
U.S. House of Representatives
2138 Rayburn House Office Building
Washington, DC 20515

Re: Hearing on H.R. 3179
The Marketplace Equity Act of 2011

Dear Chairman Smith and Ranking Member Conyers:

I write on behalf of the Software Finance and Tax Executives Council (SoFTEC) to express the views of the software industry on H.R. 3179, the "Marketplace Equity Act of 2011." If enacted, this legislation would give states the power to require that out-of-state sellers collect and remit state sales and use taxes owed by consumers who purchase goods and services from such sellers; in essence, a legislative overturn of the Supreme Court's decision in *Quill v. North Dakota*. SoFTEC strongly believes that any legislation making such significant changes must also (1) require that a state first adopt "radical simplification" of its sales and use tax laws and (2) resolve uncertainty regarding the appropriate nexus standard for imposition of state income and other business activities on out-of-state businesses. Because H.R. 3179 lacks such provisions, SoFTEC does not support this legislation in its current form. We ask that you make this letter a part of the record of the hearing on this matter.

SoFTEC is a trade association providing software industry focused public policy advocacy in the areas of tax, finance and accounting. SoFTEC's members sell their products in many states and must maintain an infrastructure that handles the administrative burden associated with collecting and remitting sales and use taxes for those states in which they have physical presence. SoFTEC's members have an interest in this legislation because its enactment would expand the number of states for which they must collect and remit sales taxes and would require significant investment to expand their infrastructure devoted to sales and use tax compliance. Enactment of the bill also could lead to an inference that the physical presence nexus standard has been repealed not only for sales and use taxes but for state income and other business activity taxes as well, significantly increasing their exposure to such taxes.

Radical Simplification:

SoFTEC does not support the bill because it would not require that states radically simplify their sales and use tax systems as a prerequisite to the grant of expanded collection and remittance authority. In deciding that the physical presence nexus standard was appropriate to protect remote sellers from the burdens of administering myriad state and local sales and use taxes, the Supreme Court in *Quill* pointed to the nation's 7800 plus taxing jurisdictions at the time. *Quill* was decided in 1992 and the number of taxing jurisdictions has grown to 9,600 in the meantime. In short, since *Quill* was decided, the burden has grown significantly with a nearly than 20% increase in the number of taxing jurisdictions.

The bill seeks to address this problem by requiring states seeking collection authority to adopt one of three approaches to the state's tax rate. A state could adopt either (1) a single statewide rate for remote sales that blended the state and local rate, (2) the highest rate in the state exclusive of local rate, or (3) the applicable destination rate in the state, so long as the state provided adequate software that eased the burden of collecting at multiple rates.

We believe the single rate per state for remote sales is the proper approach; the other two approaches should be deleted. In a single stroke, such a change would reduce from 9,600 to 45 the number of state and local taxing jurisdictions a remote seller would be faced with. States could use their internal political processes to resolve differences with local jurisdictions with regard to setting the rate and distributing the collected taxes to the individual localities. Coupled with the single form and filing and uniform state tax base components of the bill, this approach would cause much of the current complexity to recede into the background. One-rate-per-state for remote sales represents the main ingredient in the sort of "radical simplification" needed to justify repealing the physical presence nexus standard for sales and use taxes of the *Quill* decision. But, even more simplification should be required before expanded collection authority is granted.

Other Simplification Ingredients:

The only sales and use tax simplifications in the bill required of a state, in order to qualify for sales and use tax collection authority, are the exception for small sellers, the use of a special tax form for remote sales, a single authority within the state for filing the form and a single tax base for the state. While these simplifications would be welcome, they do not go nearly far enough nor do they require any sort of uniformity among the states. They would do little to reduce the remaining administrative burden on sellers required to comply with 45 state sales and use tax regimes.

There is a plethora of other simplification areas that could be required of states before any one of them is given collection authority. For instance, all states should be required to use the same tax reporting form. Having a single form would aid automation of the return preparation. In addition, there should be uniform electronic filing and payment methods. The same is true of administration of exemptions. There are many purchasers who are exempt from sales and use tax and they typically supply the seller with a form or provide data allowing the seller to prove on audit that a sale was exempt. Having a uniform exemption form or required

data elements for all states would ease the administration burden on sellers. Mandating "destination sourcing" for remote sales would foster consistency of treatment among the states. There are many other simplification criteria and we point to the good work the Streamlined Sales Tax Governing Board has done in this area (although their work is inadequate and incomplete, it is a step in the right direction).

In short, the bill's requirements for state simplification of sales and use taxes should be expanded to mandate greater uniformity and simplification among the states as a prerequisite to any grant of sales and use tax collection authority.

Physical Presence Nexus for State Income and other Business Activity Taxes:

Disputes between states and businesses over the appropriate nexus standard for imposing state taxes on out-of-state businesses are not limited to sales and use taxes. Many states point to the fact the *Quill* case only involved sales and use taxes as a reason for using a different nexus standard for other types of state taxes, such as income and other taxes based on business activity. The business community, on the other hand, believes the Commerce Clause of the Constitution does not impose different nexus standards depending on the type of tax involved and the physical presence nexus standard of *Quill* applies to all types of taxes. It would be inappropriate to eliminate the physical presence nexus requirement for sales and use taxes but leave unresolved the existing uncertainty regarding its application to other types of taxes.

In October of 2011, your Committee reported H.R. 1439, the Business Activity Tax Simplification Act of 2011 (BATSA). This bill would resolve the uncertainty regarding the appropriate nexus standard for state income and other business activity taxes by codifying the physical presence standard of *Quill* for those types of taxes. SoFTEC supports BATSA and believes Congress should pass it before (or at the same time as) it passes any legislation impacting the physical presence nexus standard for sales and use taxes.

Conclusion:

For the reasons stated above, SoFTEC does not support H.R. 3179, The Marketplace Equity Act of 2011, in its current form. We thank you for the opportunity to provide these comments. Any questions regarding them should be directed to Mark E. Nebergall who can be reached at (202) 486-3725 or mnebergall@softwarefinance.org.

Respectfully submitted,

Mark E. Nebergall
President
Software Finance & Tax Executives Council

Statement
of the
Federation of Tax Administrators

On the Topic of

Remote Sales Tax Collection Authority

Committee On the Judiciary
United States House of Representatives

July 24, 2012

For additional information call:
Marty Morris
202.301.7296

Introduction

The Federation of Tax Administrators (FTA) is an association of the tax agencies in the 50 states, District of Columbia and New York City. FTA has long supported legislation to require remote sellers to collect sales taxes. Granting states the authority to require all sellers to collect sales taxes from all customers will level the playing field for competing businesses, improve compliance with taxes that are already owed, and remove artificial restrictions that inhibit business investment.

Leveling the Playing Field for Sellers

FTA supports the objectives of HR 3179, The Market Place Equity Act. The establishment and explosion of the Internet as a marketplace has redefined the world of commerce forever. At one time considered principally an enforcement problem for the states, the disparate tax treatment between remote and local sales, which has existed for many decades, now poses challenges for local "bricks and mortar" and Internet businesses alike. This legislation should not be delayed or encumbered by special preemption legislation.

The Marketplace Equity Act and related bills respond to the U.S. Supreme Court's decisions in *National Bellas Hess* and *Quill.*[1] These decisions are widely read to exempt sellers from collecting sales tax from customers who are in a state where a seller has no physical presence. These taxes are owed but frequently go unpaid, giving the seller in that case an unfair competitive advantage over traditional local retailers.

We have provided technical comments on elements in any legislation that would assure the maximum participation of the states under the Act. The most important of these elements are:

- Authority granted to states that are either members of the Streamlined Sales and Use Tax Agreement (SSUTA) or that choose to conform their laws to federal statutory standards.
- Ability for states to designate the specific taxes covered by the generic phrase "sales and use taxes."
- Flexibility to recognize exceptions from uniform rate and base requirements that have already been agreed to between states and industry groups under SSUTA.
- Authority for states to continue to impose origin sourcing for intrastate sales or sales by non-remote sellers.
- Recognition that states may have additional ways of lowering burdens on remote sellers and the retention of authority for states to use these approaches as well.
- Preservation of state authority to require sellers to maintain necessary records.
- Exclusion of any mandatory vendor compensation provision, as this requirement would significantly reduce state participation.

FTA believes that legislation that does not have a demonstrable need or share the joint support of businesses and states should not be considered when enacting remote seller sales tax collection

1 *National Bellas Hess, Inc. v. Illinois Dep't of Revenue*, 386 U.S. 753 (1967) and *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

legislation. The clearest example of the type of legislation that should not encumber the sales tax legislation is the Digital Goods and Services Tax Fairness Act of 2011 (H.R. 1860). There is no discernible, let alone pressing, need for the legislation because states do not widely subject digital goods or services to taxation (with the long-standing exception of software). Furthermore, discriminating against digital goods and services is already illegal under the Internet Tax Freedom Act (ITFA), which specifically prohibits multiple or discriminatory taxes on electronic commerce. In addition, the states that have closely examined H.R. 1860 believe they would suffer significant revenue losses.

Finally, states have identified numerous technical deficiencies with H.R. 1860, which will create uncertainty, unnecessarily disrupt tax administration, and lead to years of litigation. Until businesses and states can reach a consensus on how to address these technical deficiencies, the Digital goods and Services Tax Fairness Act or any other preemptive legislation like it should not be considered when enacting remote seller sales tax collection legislation.

Again, we thank the Committee for the opportunity to present our views on the important topic of remote seller sales tax collection legislation. We urge Congress to enact legislation like HR 3179 this year.

07-20-12 12:17pm From-DIRECTHOLDINGSAMERICASINC +7036634630 T-069 P.03/03 F-297

Direct Holdings Americas Inc.

8280 Willow Oaks Corporate Drive
Fairfax, Virginia 22031-4511

703 663 4500

July 20, 2012

The Honorable John Conyers
US House of Representatives
2409 Rayburn House Office Building
Washington DC 20515

Dear Congressman Conyers:

The House Judiciary Committee is holding a hearing July 24th to discuss overturning a twice-vetted Supreme Court decision (1967's *National Bellas Hess* ruling and 1992's *Quill* decision that upheld the 1967 law) that holds the imposition of chaotic state and local sales taxes constitutes a significant barrier to interstate commerce. This Constitutionally-protected right is what enables our national economy to grow.

If we are forced to comply with the provisions envisioned in H.R. 3179, our business located in Fairfax, Va, will be severely harmed, with implications for our employment outlook. Here's how: our 60 employee company would incur a huge administrative and financial burden in time and costs implementing a tax collection regime for 9,600 taxing jurisdictions, to create a tax department to handle audits from 45 states and DC, and a legal team to handle any law suits or administrative claims from states and consumers. Moreover, our company receives a fair number of check payments, so listing 9,600 tax jurisdictions on our websites, literature or marketing materials for consumers to calculate the proper tax is impossible and will result in over and underpayments of tax which we would have to resolve to make the sale.

We would like to register our strong opposition to H.R. 3179 in its current form. We think there are sound policy reasons to preserve the status quo, but even if you choose to change the *Quill* decision, we urge you to write safeguards into statute so small- and medium-sized businesses can cope with the complexity this brings.

We can demonstrate that requiring all remote sellers to collect sales tax will add less than 1% to total state and local tax revenues. We can point to the Commerce Department's own statistics to show that more than 90% of the dollars transacted on the Internet are B2B for which most every dollar is already being collected in use tax. This is not a cure all for state and local revenue shortfalls. At the very least, there is time to do this right without unintended consequences. This is not the time to be putting more jobs at risk, especially at small- and medium-sized businesses, which make up the backbone of the employment in America.

Thank you for your urgent consideration of this matter.

Sincerely,

Christopher Hearing
President
Direct Holdings Americas Inc.

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Texas Retailers Association
The Voice of Texas Retail
504 West 12th Street • Austin, Texas 78701 • (512) 472-8261 • (800) 299-4872 • Fax (512) 474-5011 • www.txretailers.org

July 24, 2012

The Honorable Lamar Smith
Chairman
Judiciary Committee
U.S. House of Representatives
Washington, D.C. 20151

Dear Chairman Smith:

On behalf of the Texas Retailers Association, I write to thank the Judiciary Committee for holding today's hearing on H.R. 3179, the Marketplace Equity Act. Previous hearings have demonstrated not only the undeniable need for this legislation but also the broad bipartisan support this legislation currently enjoys. We now urge the committee to proceed with the mark-up of this legislation that is vitally important to Main Street retailers and the communities they serve.

The current tax system puts brick-and-mortar merchants at a distinct disadvantage to online sellers. It allows Internet sellers without a physical presence in a given state to escape sales taxes collection, even when those taxes are owed to the state. This unfairness comes at the expense of local businesses, which are required to collect taxes and forced to charge higher prices to consumers as a result. That's not good for consumers or for healthy market competition in the retail industry.

In 2011, Texas took a big step to provide for a greater degree of sales tax fairness as it applies to businesses with nexus in our state. Courageous state legislators like John Otto passed legislation clarifying our state laws on nexus. No longer can an out-of-state company with a physical presence in Texas play corporate games to avoid our laws.

Unfortunately, in this case a Texas solution is insufficient to address that which is a national issue. Opportunities remain for online sellers to operate without collecting and remitting the sales taxes that are rightfully owed. It is estimated that states and communities lose $24 billion a year in uncollected sales taxes on remote sales. State-by-state attempts to close this collection loophole has only increased the confusion and complexity for retailers attempting to comply with sales tax collection laws.

The Marketplace Equity Act is not a bill to create yet another tax on retailers or on consumers. This legislation only seeks to provide states the mechanism and authority to collect sales taxes that are due by establishing consistent, uniform rules for all businesses as it relates to sales tax collection. On behalf of the Texas Retailers Association, we thank you for your consideration and respectfully request you immediately proceed to mark-up this important legislation.

Very truly yours,

Ronnie Volkening
President
Texas Retailers Association
The Voice of Texas Retail
rvolkening@txretailers.org

July 18, 2012

The Honorable John Conyers, Jr.
US House of Representatives
2426 Rayburn House Office Building
Washington DC 20515

Dear Congressman Conyers:

The House Judiciary Committee is holding a hearing July 24th to discuss overturning a twice-vetted Supreme Court decision (1967's *National Bellas Hess* ruling and 1992's *Quill* decision that upheld the 1967 law) that holds the imposition of chaotic state and local sales taxes constitutes a significant barrier to interstate commerce. This Constitutionally-protected right is what enables our national economy to grow.

If we are forced to comply with the provisions envisioned in H.R. 3179, our business located in Neenah, WI will be severely harmed, with implications for our employment outlook. Here's how: our small company would incur a huge administrative and financial burden in time and costs implementing a tax collection regime for 9,600 taxing jurisdictions, to create a tax department to handle audits from 45 states and DC, and a legal team to handle any law suits or administrative claims from states and consumers. Moreover, our company receives a significant amount of check payments, so listing 9,600 tax jurisdictions on our websites, literature or marketing materials for consumers to calculate the proper tax is impossible and will result in over and underpayments of tax which we would have to resolve to make the sale.

We would like to register our strong opposition to H.R. 3179 in its current form. We think there are sound policy reasons to preserve the status quo, but even if you choose to change the *Quill* decision, we urge you to write safeguards into statute so small- and medium-sized businesses can cope with the complexity this brings.

We can demonstrate that requiring all remote sellers to collect sales tax will add less than 1% to total state and local tax revenues. We can point to the Commerce Department's own statistics to show that more than 90% of the dollars transacted on the Internet are B2B for which most every dollar is already being collected in use tax. This is not a cure all for state and local revenue shortfalls. At the very least, there is time to do this right without unintended consequences. This is not the time to be putting more jobs at risk, especially at small- and medium-sized businesses, which make up the backbone of the employment in America.

Thank you for your urgent consideration of this matter.

Sincerely,

Scott Swanson
President
XSell Response, Incorporated

48 Jewelers Park Drive, Suite 200, Neenah, WI 54956 – 800-510-8010
Scott.swanson@xsellresponse.com

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