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MARKETPLACE FAIRNESS ACT

Can you imagine a public policy battle that has been going on for over 60 years? There is one. In the 1960's, it pitted "brick and mortar" main street retailers against mail order catalogue companies. Today, it pits "brick and mortar" retailers against online retailers. The debate is over the issue of whether out-of-state sellers should collect and remit use taxes from consumers for the state in which the customer resides. With forty-five states having sales and use tax regimes and with the need for revenue at the state level as important as ever, this may be the last chapter in the book.

The Senate is expected to vote today or tomorrow on a cloture motion that gives the brick and mortar retailers their best chance at securing legislation to level the playing field.

Let's the wind the clock back to understand the issue.

Remote Seller Nexus

Under the structure of state taxation, sales and use taxes are actually imposed on the purchaser of goods and services. The obligation, if any, on the seller is to

collect and remit the tax. A sales tax is the tax collected by a seller on a transaction which occurs in the state. The use tax is essentially a fiction created to capture the sales tax on sales made out of state. The purchaser is obligated to pay the use tax on any goods or services the purchaser buys out of state and "uses" in the state. Theoretically, the purchaser is always obligated to pay either the sales tax or the use tax. However, few purchasers voluntarily pay the use tax, and it is impossible to enforce compliance on a purchaser-by-purchaser basis.

The state can force the in-state seller to become a collector of the sales tax since it has jurisdiction over the seller and can use "leverage" such as the seizure of assets to force compliance. The word "nexus" is often used to describe the physical presence necessary for the state to assert jurisdiction over the seller. If the seller has a facility in the state, the question of jurisdiction is easily resolved. In the case of an out-of-state seller, determining whether the seller has sufficient contact with a state to warrant an obligation to collect and remit a state use tax on transactions with a purchaser residing in the state has been a source of disputes for several decades, long before the Internet.

In *National Bellas Hess v. Illinois Department of Revenue* (1967), the Supreme Court ruled that states could not collect a sales or use tax from a firm that did not maintain a retail outlet within the state's boundaries. In legal parlance, the company had to have "nexus," or a connection with the state, upon which the state could claim jurisdiction.

In 1992, the Supreme Court decided the *Quill Corp. v. North Dakota* case involving a North Dakota statute drafted to specifically circumvent the earlier *National Bellas Hess* case. The North Dakota statute was drafted to define nexus to include "regular or systematic solicitation of a consumer market." Regulations further defined this as three or more advertisements within a 12-month period. Justice Stevens, speaking for the Supreme Court, said: "We do not share [North Dakota's] conclusion that the ruling of *Bellas Hess* is no longer good law."

The Supreme Court, however, did make an observation that is essential to understanding the significance of the Streamlined Sales Tax Project (SSTP) agreement and possible federal legislation on nexus: "Our decision is made easier by the fact

that the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve. No matter how we evaluate the burdens that use taxes impose on interstate commerce, Congress remains free to disagree with our conclusions."

Streamlined Sales Tax Project

On November 12, 2002, representatives of 33 states and the District of Columbia voted to approve a multi-state agreement to simplify the nation's sales tax laws by establishing one uniform system to administer and collect sales taxes on the trillions of dollars spent annually in out-of-state retail transactions. The effort is known as the Streamlined Sales Tax Project (SSTP). Under the agreement known as the Streamlined Sales and Use Tax Agreement (SSUTA), a certain number of states with a certain percentage of the population needed to be in compliance in order for the system to go into effect. That number was reached.

Twenty-four states have adopted the simplification measures in the Agreement (representing over 33 percent of the population). The following states have passed legislation to conform to the SSUTA: Arkansas, Georgia, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, Nevada, New Jersey, North Carolina, North Dakota, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Vermont, Washington, West Virginia, Wisconsin and Wyoming.

The goal of the SSTP is to provide states with a Streamlined Sales Tax

System (SSTS) that includes the following key features:

- Uniform definitions within states tax laws.
- States will be allowed one state rate and a second state rate in limited circumstances (the second rate would cover food and drugs).
- State level tax administration of all state and local sales and use taxes. Each local jurisdiction will be allowed one local rate.
- Uniform sourcing rules.
- Simplified exemption administration for use- and entity-based exemptions.
- Uniform audit procedures.

The Agreement went into effect when 10 states comprising at least 20 percent of the population of states imposing a sales tax came into compliance. However, collection by sellers of sales and use taxes on remote sales remains voluntary under the Agreement until either Congress or the Supreme Court acts to make this collection mandatory.

Federal Nexus Legislation

The Senate bill, S. 743, is constructed around acceptance of the SSUTA by states. Under the bill, states that voluntarily are already or become Member States of the SSUTA would be able to require remote sellers to collect and remit sales and use taxes after 90 days. States that do not wish to become members of SSUTA would be allowed to collect the taxes only if they adopt certain minimum simplification requirements and provide sellers with additional notices on the collection requirements. The requirements are similar to but not as comprehensive as the conditions SSUTA Members have accepted.

Since it seems like everybody wants to get into the internet selling business, to allay the concerns of businesses that might do some internet sales, the proponents included an exemption for those internet sales only (as opposed to total gross receipts) which means it is high exemption unless you are exclusively an internet-based seller. The legislation exempts sellers who make less than \$1 million in total remote sales in the year preceding the sale to qualify for an exemption and not be required to collect the tax.

Some large internet sellers like Amazon have agreed to support the bill in part because of specific states' efforts to get jurisdiction over them and in part, because they have increased their physical presence in more states.

The supporters are buoyed by a test vote on an amendment to the Senate's budget resolution, which passed handily. (But, as explained in previous SBLC Reports on the budget process, the budget resolution is a soft victory, as it is not going anywhere.)

This bill is being brought straight to the floor because the Chair of the Senate Finance Committee, which has jurisdiction over the bill, Senator Max Baucus (D-MT), opposes the bill. His state is one of the five without a sales tax.

There is a House companion bill. The House bill does not fall within the jurisdiction of Ways and Means Committee but rather under the jurisdiction of the Judiciary Committee. Representative Bob Goodlatte (R-VA) is chair of that committee and he opposes the bill.