

## Streamlined Sales Taxes

California recently enacted legislation temporarily repealing a requirement that certain online retailers collect sales tax, with the provision that the law will go back into effect on Sept. 15, 2012, if no national streamlined sales tax legislation is enacted. In this interview, Annette Nellen, a tax professor with San Jose State University and a blogger at 21st Century Taxation, provides an overview of several pending federal bills, including S. 1832, which would allow states to mandate collection by remote sellers without requiring the states to conform to the Streamlined Sales and Use Tax Agreement (SSUTA).

### California's Delay in Online Collection Law Sets Stage For Federal Solution, With or Without Streamlined System

ANNETTE NELLEN, INTERVIEWED BY STEVEN ROLL

**BNA:** Under California's A.B. 155, the new state law requiring online retailers to collect sales tax is repealed retroactively to the June 28 date of enactment. But that law (ABX 28) will go back into effect Sept. 15, 2012, if no national sales tax rules are enacted by July. What do you think the prospects are for the Main Street Fairness Act (S. 1452/H.R. 2701) now pending in Congress?

**NELLEN:** I do not think the act is getting a lot of attention in Congress. While there was a hearing in April on the business activity tax nexus issue, I do not believe there has been a hearing specifically on streamlined sales tax legislation since 2007. Perhaps with the Amazon debate in the states heating up and the introduction of a modified approach to getting remote vendors to collect sales tax (H.R. 3179), it will get some attention. If Amazon pursues federal legislation, it would likely be joined by some multichannel vendors that support the act, such as J.C. Penney.

There has been greater attention this year in Congress on the business activity nexus issue (income and gross receipts taxes), including the House Judiciary Committee marking up the Business Activity Tax Simplification Act (H.R. 1439). Given that states are not

fond of the BATSA bill, but are fond of the Main Street Fairness bills, perhaps Congress will need to combine these bills to improve their chances. Given other items on the congressional agenda, though, I don't see any of these bills being a high priority.

By the way, I think the first time a Main Street Fairness type bill was proposed was in the 103rd Congress by Sen. Dale Bumpers (D-Ark.).<sup>1</sup>

**BNA:** You mention a "modified approach" to remote collection. What is that bill about?

**NELLEN:** The Marketplace Equity Act (H.R. 3179) aims to enable states to collect tax from remote vendors with sales above a de minimis level (\$1 million of sales nationwide or \$100,000 of sales in the state). It does not require that states adopt the Streamlined Sales and Use Tax Agreement (SSUTA) to be eligible to collect from remote vendors, but states must have a simplified rate structure in place. It appears the bill aims to get to one rate per state. For example, one option for a state is to have a "single State-wide blended rate that includes both the State rate and applicable rates of local jurisdic-

<sup>1</sup> S. 1825, the Tax Fairness for Main Street Act of 1994.

tion, as determined by the State.” H.R. 3179 also requires that the state and local tax bases be the same.

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**BNA:** How is this bill different from the measure introduced Nov. 10 by Sens. Mike Enzi (R-Wyo.), Lamar Alexander (R-Tenn.) and Majority Whip Dick Durbin (D-Ill.)? S. 1832 is called the Marketplace Fairness Act—is it basically the same thing?

**NELLEN:** Unlike the Marketplace Equity Act (H.R. 3179), the Marketplace Fairness Act (S. 1832) recognizes the states that have adopted the SSUTA. S. 1832 authorizes states that have adopted the SSUTA to collect sales and use tax from remote sellers, but it also provides an alternative allowing other states to also collect tax from remote sellers “if the State adopts and implements minimum simplification requirements” specified in the legislation. A non-SSUTA state’s ability to collect from remote sellers would not be effective until six months after enacting the simplifying legislation. A SSUTA state would be able to start collecting from remote vendors by the start of the calendar quarter that is at least 90 days after enactment of S. 1832. The simplification provisions for non-SSUTA states include provision of software and third-party collectors, a uniform state-local tax base, and destination sourcing. S. 1832 also provides a small seller exception for sellers with gross annual receipts from remote sales in the United States of \$500,000 or less.

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So, at this point, we have three approaches for enabling states to collect sales tax from remote vendors. I think S. 1832 is the option that is going to provide the most uniform relief to states and protections to vendors. S. 1832 recognizes that many states have already implemented some simplifications by following the SSUTA. It also recognizes that some states are unlikely to join the SSUTA, such as California, due to its size. (It is a large-population state, but it would have only one vote on the SSUTA Governing Board.) Under S. 1832, non-SSUTA

states would still have to enact the simplifications specified in the bill in order to collect from remote vendors.

There are still a few issues to resolve in reaching a single approach, including the description and dollar amount of a de minimis exception, which varies among the three bills. Another possible issue to address is highlighted by S. Res. 309, introduced by Sen. Ron Wyden (D-Ore.), aimed at “Supporting the preservation of Internet entrepreneurs and small businesses.” S. Res. 309 includes a “whereas” clause stating: “any Federal legislation that would upset the free and fair Internet marketplace and allow State governments to impose new, onerous and burdensome sales tax-collecting schemes on out-of-State, Internet-enabled small businesses would adversely impact hundreds of thousands of jobs, reduce consumer choice, and impede the growth and development of interstate commerce.” While this resolution has only six sponsors, it may have a bearing on the definition of vendors meeting a de minimis threshold to be exempted from collecting sales tax in states where they have no physical presence as well as an impact on the degree of simplifications required for states to collect from remote vendors.

Yet, the movement from S. 1452/H.R. 2701—which would only let SSUTA states collect from remote vendors—to S. 1832, which would let both SSUTA states and states that adopt specified simplifying measures collect, is a big step forward in reaching the point where such legislation may indeed be enacted. I think that, given continued difficult budget scenarios in the states and the financial challenges the federal government has in continuing to help states, members of Congress and President Obama might view enactment of S. 1832 as a way to help states increase revenues (without enacting any new taxes or increasing tax rates) and without using federal dollars.

**BNA:** It seems there is some momentum growing for legislative solutions that do not involve the SSUTA. Do you see this as a hazard to achieving ultimate uniformity in state sales taxation—or is it a political necessity in order to enact a mandate for collection on remote sales?

**NELLEN:** Yes, S. 1832 will mostly lead some states that may have been considering adopting the SSUTA to forego such an effort and instead adopt the simplifications specified in that bill. Yet, there may still be advantages for some states to adopt the SSUTA, including that there is a periodic review by the Governing Board to be sure the state is still in compliance with the SSUTA. That can serve as a protection for the SSUTA states. In contrast, a non-SSUTA state may face legal challenges from vendors that it has not adequately enacted the required simplifications. If such challenges arise, states may find it advantageous to join the SSUTA. In addition, the SSUTA offers an approach to uniformly addressing new issues, such as ones recently brought before the SSUTA Governing Board on sourcing of digital goods and treatment of coupon and voucher deals. It is possible that after enactment of S.

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1832, vendors may encourage non-SSUTA states to adopt SSUTA if they find that the existing landscape—which would include 21 SSUTA states (or 24, if three associate states are approved), and up to 22 non-SSUTA states—presents complications for such vendors.

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**BNA:** As you wrote on your blog, Amazon spent more than \$5 million on a referendum campaign to block California’s “click-through” nexus law. If Congress fails to enact the Main Street Fairness Act by July 2012, is there anything to stop Amazon from launching another referendum campaign?

**NELLEN:** Not unless there is some way for the California Legislature to stop the referendum by the nature of the law. If not, I think they could pursue a ballot initiative (sorry, I’m not an expert on these voting topics). Will they pursue another voter initiative? This is just a personal opinion, but I say no. It is costly and the process brings more attention to the entire issue. There is also a possibility that voters might think the ballot initiative would eliminate sales tax on goods purchased on the internet. What would happen if voters learned they still owed the use tax, but Amazon was pushing the initiative so that it would not have to collect the tax?

**BNA:** If federal legislation is enacted, what would California need to do to become eligible to sign on to the Streamlined Sales and Tax Agreement?

**NELLEN:** It would need to be carefully looked at. We might need to modify some definitions. For example, in California, the constitution says we cannot tax food (a result of the voters repealing the snack tax in the 1990s). If our definition of food doesn’t tie to that used in the SSUTA, we might need to modify that constitutional provision (Cal. Const. art. XIII, §34). I haven’t studied this, but that is one of many areas that would need to be explored.

**BNA:** According to published reports—which you cite on your blog—Amazon suggested a deal with California to build a distribution center in the state if California would delay the effective date of the online sales tax legislation. Amazon recently made a similar agreement with tax authorities in Tennessee. The state will continue to honor a sales tax exemption for Amazon until Jan. 1, 2014, in exchange for Amazon’s promise to locate warehouses and launch other projects in the state. Is it foreseeable that similar agreements could be struck with other states?

**NELLEN:** I think it would be difficult due to outcries by main street vendors and perhaps even voters who might see it as Amazon, a large company, getting a tax break (although it is just a tax collection break). But, given high unemployment rates, voters might be fine with it.

Main street vendors and many legislators will oppose such measures.

**BNA:** After no “Amazon” laws were enacted in 2010, five states (Arkansas, California, Connecticut, Illinois, and Vermont) enacted such provisions in 2011. How effective are these “click-through” nexus laws?

**NELLEN:** I do not think the click-through nexus laws are effective. They do not apply to all e-commerce vendors, only those that have affiliate relationships with persons in the state who provide some type of direct or indirect referral to the vendor through a website. Not all remote vendors have such relationships. In addition, these bills are of questionable constitutional validity, as they generally suggest a physical presence through an advertising connection rather than a solicitation activity.

Also, vendors with such relationships can easily cancel the affiliate contracts (although that is not good for relationships with such affiliates.) For this reason, revenue estimates for these state bills are likely overstated. The legislative analysis of California’s AB 153 indicated an uncertain revenue estimate of \$152 million in FY 2011-12 and \$317 million in FY 2012-13. This analysis noted that these estimates drop to \$114 million and \$234 million, respectively, should Amazon end its relationships with its California affiliates. The figures go down further if other internet vendors, such as Overstock.com, do the same.

**BNA:** One key inquiry regarding whether remote vendors can be required to collect use tax is whether the obligation is burdensome. In view of the technological advances since *Quill* was decided in 1992, do you think it is fair to say that use tax collection has become less burdensome than it once was?

**NELLEN:** I think there continues to be a burden on remote vendors to collect sales tax in all states due to variations among the states on what is taxed and varying rates among local jurisdictions. For example, the Direct Marketing Association recently won an injunction in its lawsuit challenging the Colorado reporting law (H.B. 1193). In contrast to New York’s “Amazon” law, H.B. 1193 does not require vendors to collect the tax, but in certain circumstances, to notify customers that a tax could be due. The opinion granting the injunction cites a Colorado Department of Revenue estimate that the smallest retailers would have first-year compliance costs between \$3,100 and \$7,000 under H.B. 1193. That is significant, particularly if more states were to take that approach.

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**BNA:** What is your prediction for 2012? Will states continue to enact “click-through” nexus laws or will they be more likely to wait for a federal solution?

**NELLEN:** I would not be surprised to see a few more. There is still litigation pending in New York. I think if New York wins, that will lead more states to adopt the New York approach to this legislation. But, it still doesn't help much in sales tax collection since it is too easy for the affected vendors to cancel their associate agreements so they are no longer subject to the law. States really should be working with Congress and vendors to get the Main Street Fairness bill or new Marketplace Equity Act (H.R. 3179) or some variation of them passed.

Consideration should also be given to technological solutions that go beyond our traditional paper and pen

reporting schemes (or today's computerized form completion system). Why not have a system that allows the state to collect the sales or use tax at the same time that the customer's credit card or PayPal account is used for the product or service? The system could be set up to keep the state from knowing the exact item purchased, and it could alleviate any need for the vendor to file sales tax reports or for customers to deal with the use tax. States would collect the tax daily. The system could also handle returns where any refund to the customer by the vendor would also generate a refund of the sales tax, charged to the state tax agency.