Marketplace Fairness Act

Tax Policy & Simplification Committee
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Agenda

- Introduction
- The *Quill* physical presence test
- States Post-*Quill*
- Magnitude of non-collection
- Policy responses
  - State-level
  - Federal legislation
  - Alternatives if Congress fails to act

Introduction

- The policy goal: To effectively collect use tax on all taxable purchases, thereby:
  - Imposing an equitable consumption tax
  - Leveling the competitive playing field among sellers
  - Capturing lost revenue
- The problem: The *Quill* physical presence nexus requirement
  - Consumers have nexus, but collection is often impractical
  - Sellers are efficient tax collectors, but some sellers have no physical presence (no nexus)
- The MFA solution: Federal legislation overruling *Quill*, conditioned on reducing seller compliance burdens
- Other approaches?

The *Quill* Physical Presence Test

- *National Bellas Hess*
  - Remote mail order company
  - Physical presence required by both Due Process and Commerce Clauses
  - Compliance burden rationale
- *Quill*
  - Physical presence required only by Commerce Clause (“substantial nexus”)
  - Compliance burden rationale
  - Role of *stare decisis*
  - Cleared way for Congress to act
  - 24 years later …

States Post-*Quill*

What is physical presence?

- Slightest presence (diskettes, temporary presence)
- Presence unrelated to sales or marketing of the taxable product (*National Geographic*)
- Independent contractors and agents
  - Activities that establish and maintain the market
  - Other activities and persons (printers, fulfillment centers, teachers, party hostesses, multilevel marketers)

States testing the limits:

- Affiliate nexus
- Click through nexus
- Digital nexus (cookies, software, other)
- Information reporting rather than collection

Magnitude of Non-Collection

ESTIMATED UNCOLLECTED USE TAX FROM ALL REMOTE SALES IN 2012

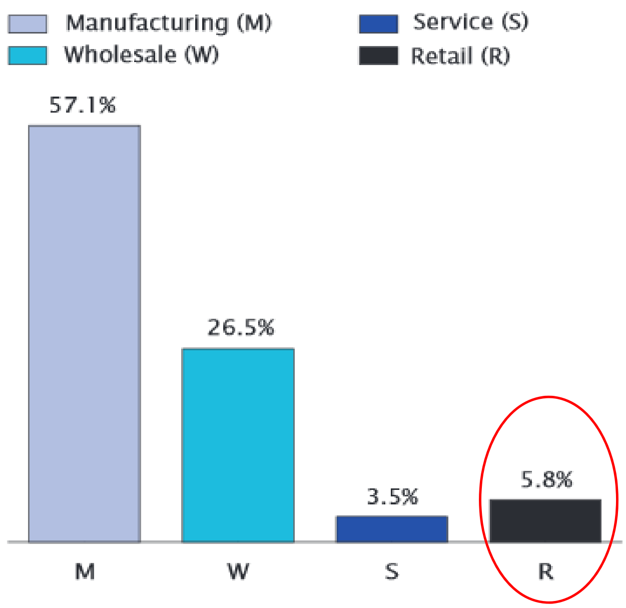
	Non-Electronic Business to Customer	Non-electronic Business to Business	Electronic Business to Business and Business to Customer	Total
California	1,136,801,607	1,118,366,340	1,904,500,000	4,159,667,947
Colorado	103,065,552	76,798,022	172,700,000	352,563,574
New York	516,559,974	384,908,277	865,500,000	1,766,968,251
North Carolina	127,621,735	95,095,757	213,800,000	436,517,492
Total	**6,800,214,113**	**5,067,095,451**	**11,392,700,000**	**23,260,009,564**

NCSL - http://www.ncsl.org/research/fiscal-policy/collecting-ecommerce-taxes-an-interactive-map.aspx

Table 1 **Fiscal Year Forecasts of Use Tax Revenue Losses** **(Millions of Dollars)**			
	Fiscal Year 2012-13	2013-14	2014-15
Business to Consumer (B-to-C)	$492	$547	$607
Business to Business (B-to-B)	$520	$574	$472
Total Use Tax Revenue Losses	$1,012	$1,121	$1,080
Total Use Tax Revenue Losses by Funding Jurisdiction			
State	$785	$869	$837
Local	$227	$251	$242
Total State and Local Use Tax Revenue Losses	$1,012	$1,121	$1,080
Note: Totals may not add because of rounding.			

BOE, 2013, E-commerce and mail order sales - https://www.boe.ca.gov/legdiv/pdf/e-commerce-08-21-13F.pdf

E-commerce as Percentage of Total Shipments/Sales/Revenues: 2013



Note: For the estimates of e-commerce as a percentage of total shipments/sales/revenues by sector that are shown in this table, the corresponding standard errors can be found at <www.census.gov/econ/estats/2013/all2013tables.html>.

Source: U.S. Census Bureau, 2013 Annual Survey of Manufactures; 2013 Annual Wholesale Trade Survey; 2013 Service Annual Survey; 2013 Annual Retail Trade Survey.

Policy Responses – State Level

- Pushing the boundaries of the physical presence test
- The Streamlined Sales and Use Tax Agreement (SSUTA)
- Re-visiting *Quill*: the Kennedy concurrence in *DMA*

States Push the Boundaries of the Physical Presence Test

- Audits
  - Look for any property, activity, employee, agent, affiliate or rep in the state.
- Legislation
  - Affiliate
  - Reporting

State Legislative Approaches

- Affiliate Nexus Laws
  1. **Related entity and some commonality**, such as product or trademark.
  2. **Attributional nexus – some connection with an in-state entity or individual**
     1. **Example - "Click-through" nexus –** Someone has your website link (or similar arrangement) and earns commissions for sales completed.
        - aka "Amazon" laws (but applies to other vendors too)
- Reporting - Require remote vendor to notify buyers of use tax and/or report sales to customer and state (for example, Colorado 2010).

Related entity and some commonality

Example - Alabama §40-23-190 [excerpt]

- "(a) An out-of-state vendor has substantial nexus with this state for the collection of both state and local use tax if:
  - (1) The out-of-state vendor and an in-state business maintaining one or more locations within this state are related parties; and
  - (2) The out-of-state vendor and the in-state business use an identical or substantially similar name, tradename, trademark, or goodwill, to develop, promote, or maintain sales, or the in-state business and the out-of-state vendor pay for each other's services in whole or in part contingent upon the volume or value of sales, or the in-state business and the out-of-state vendor share a common business plan or substantially coordinate their business plans, or the in-state business provides services to, or that inure to the benefit of, the out-of-state business related to developing, promoting, or maintaining the in-state market."
- Other examples (others exist as well):
- KS Sec. 18(h)(1) (revised April 2013) "Retailer doing business in this state"
  - http://www.sjsu.edu/people/annette.nellen/website/KS_Reg4-25-13_SB83_affiliate_nexus.pdf

Click-through nexus

- Legislation first enacted in New York in April 2008
- New York history
  - Broadened definition of "vendor" (§1101(b)(8)).
  - Sellers presumed to be soliciting business and thus required to collect tax if, per an agreement, they compensate NY residents for directly or indirectly referring potential customers.
  - Referrals may be made through a website or other means.
  - Presumption only applies to sellers with over $10,000 of sales to NY customers made via the referrals in the prior 4 quarters.
  - Sellers may rebut presumption by showing that the residents did not solicit sales in NY for them.
    - Guidance - TSB-M-08(3)S & TSB-M-08(3.1)S.
    - In reality, may be tough to do.
  - Amnesty available for those who register due to law change.
  - Estimated to generate $47 million in 2008/2009 and $73 million in 2009/2010
    - Means that New Yorkers were not very compliant in paying use tax (same is true in all states).
  - NY courts held law to be constitutional. USSC denied cert.

Streamlined Sales and Use Tax Agreement (SSUTA)

- Uniform law to make multistate compliance simpler (so less impediment to interstate commerce).
- Simplification includes uniform definitions, paperwork, technological approaches, and registration (one-stop registration).
- Adopting states must also offer temporary amnesty to sellers who register to collect.

www.streamlinedsalestax.org

SSUTA adopted by

- **Full Member States (24) -** 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.

http://www.streamlinedsalestax.org/index.php?page=gen_3

SSUTA – add'l observations

- Agreement has incentives for remote vendors to collect sales tax:
  - Amnesty (available for limited time periods).
  - Simplified collection methods including use of third parties and technology.
- Member states hope Congress will enact legislation saying SSUTA adopters may collect from remote vendors.
- Problems:
  - Still some complexity.
  - Several amendments already made to SSUTA.

Revisit *Quill*

***Direct Marketing Association v Brohl, Exec Dir, Colorado Dept of Revenue*, No. 13-1032 (3/3/15)**

Justice Kennedy, concurring opinion:

Perhaps given "changes in technology and consumer sophistication," it is time to revisit the Court's 1992 decision in *Quill*, 504 U.S. 298.

And, he said … that *Quill* was a case "questionable even when decided, [that] now harms States to a degree far greater than could have been anticipated earlier."

Alabama Ready to Test *Quill*

Reg - https://revenue.alabama.gov/rules/810-6-2-.90.03.pdf

810-6-2-.90.03 Requirements for Certain Out-of-State Sellers Making Significant Sales into Alabama. **(NEW RULE)**

(1) Notwithstanding the provisions of Rule 810-6-2-.90.01, entitled Seller's Responsibility to Collect and Pay State Sales Tax and Seller's Use Tax, out-of-state sellers who lack an Alabama physical presence but who are making retail sales of tangible personal property into the state have a substantial economic presence **in** Alabama for sales and use tax purposes and are required to register for a license with the Department and to collect and remit tax pursuant to Section 40-23-67, Code of Alabama 1975, when,

(a) Seller's retail sales of tangible personal property sold into the state exceed $250,000 per year based on the previous calendar year's sales; and

(b) Seller conducts one or more of the activities described in Section 40-23-68, Code of Alabama 1975;

(2) Sellers may satisfy the requirements described in (1) above by one of the following methods:

(a) Using the collecting, reporting and remitting provisions of Article 2, Chapter 23 of Title 40, Code of Alabama 1975, or

(b) Using the collecting, reporting and remitting provisions created by the Simplified Sellers Use Tax Remittance Act codified at §§ 40-23-191 through 40-23-199, Code of Alabama 1975.

(3) This rule shall apply to all transactions occurring on or after January 1, 2016.

Washington too (maybe) … (HB 2224)

Proposed regulation: §902 at Chapter 82.08 RCW

(8) Therefore, the legislature intends by this act to address the significant harm and unfairness brought about by the physical presence nexus rule by testing the boundaries of the rule. This act also sets up a legal challenge to the physical presence nexus rule that could potentially lead to the United States supreme court reevaluating *Bellas Hess* and *Quill* or congress enacting legislation authorizing and establishing the requirements for states to impose a sales tax collection duty on remote sellers. To achieve these objectives, this act establishes clear statutory guidelines for determining when sellers are required to collect Washington's sales tax. These guidelines clarify the extent of the traditional physical presence standard and also incorporate an "economic nexus" standard under which a remote seller would establish a substantial nexus with this state solely by generating a meaningful amount of sales into this state. This act also amends the statutory guidelines for determining whether a taxpayer has sufficient nexus for purposes of the state's business and occupation tax.

Policy Responses – Federal Legislation

- Variations of Marketplace Fairness proposals
- Common issues
- Politics and the prospects for passage: the competing interests

Federal Proposals – Variations of Marketplace Fairness

- Proposals date back to at least 1994
- 114th Congress:
  - S. 698, Marketplace Fairness Act of 2015
  - H.R. 2775, Remote Transactions Parity Act of 2015
  - Goodlatte hybrid origin sourcing proposal -→
- Common themes:
  - SSUTA or states enact specified simplifications
  - Software provided to vendors
  - Taxability info to vendors
  - One tax form (state and local)
  - Small seller exemption

Draft Origin Sourcing Proposal

- Nexus sales taxed and sourced as usual
- Non-nexus sales sourced to origin state and taxed under origin state rules and rates, *however*, some buyers permitted to claim destination state exemptions
- Origin states required to redistribute the taxes they collect to the appropriate destination states
- Remote sellers based in states that do not impose a sales tax required either to (a) disclose purchaser information to taxing authorities in destination states or (b) collect tax at the lowest sales tax rate among the states that impose sales taxes
- A newly-created commission would draft a distribution agreement governing administration of the origin-sourcing regime

Federal Proposals – Common Issues

- How much simplification is enough?
  - Definitions of base?
  - Number of rates?
- Small sellers – how to define? -→
- Enforcement
  - Who audits? How many?
  - Protection to vendor?
- Creation of nexus for other taxes?
- Merge with other multistate bill(s)?

More – issues of seller exemption

How to define de minimis rule or exemption?

- What is the dollar threshold?
- How measured?
  - S. 698 – looks at "remote sales"
    - So, physical presence still relevant.
- Scope of the measure
  - Example – if based on remote sales
    - BIG CO has $40 million sales in California and $200,000 in each of 3 other states
      - S. 698 – only files in California
    - SMALL CO has $400,000 sales in California and $100,000 in each of 12 states – files in CA and the 12 states.

Federal Proposals – Politics and Competing Interests

- Opposing views in Congress -→
- States and local governments
  - One rate per state?
- Conflicts among vendors -→
- Consumers and anti-tax sentiment
  - May view remote vendor collection as new tax if are not presently paying use tax.

Opposing views in Congress

5/6/13 – Senate **passes** S. 743

11/30/15 Letter to Senator McConnell and Speaker Ryan from Senators Rubio, Ayotte, Daines and Lee:

- "As people across our nation make online purchases today as part of Cyber Monday, we write to urge Republican leadership to reject any efforts to impose a misguided and destructive Internet tax collection scheme on our small businesses that rely on the Internet to tap into growing markets, expand their operations, and create jobs….
- Under this new tax, online retailers would be vulnerable to audits from thousands of municipalities nationwide - presenting compliance and legal costs that could easily skyrocket as businesses are force to defend themselves against audits from money-hungry regulators in faraway places."

2015 - Senator Rubio – "Oppose the Marketplace Fairness Act, a massive, new Internet sales tax that will crush small and medium-sized businesses and kill jobs."

Congressman Goodlatte – Chair of House Judiciary Committee

Basic Principles on Remote Sales Tax

1. **Tax Relief** – Using the Internet should not create new or discriminatory taxes not faced in the offline world. Nor should any fresh precedent be created for other areas of interstate taxation by States.

2. **Tech Neutrality** – Brick & Mortar, Exclusively Online, and Brick & Click businesses should all be on equal footing. The sales tax compliance burden on online Internet sellers should not be less, but neither should it be greater than that on similarly situated offline businesses.

3. **No Regulation Without Representation** – Those who would bear state taxation, regulation and compliance burdens should have direct recourse to protest unfair, unwise or discriminatory rates and enforcement.

4. **Simplicity** – Governments should not stifle businesses by shifting onerous compliance requirements onto them; laws should be so simple and compliance so inexpensive and reliable as to render a small business exemption unnecessary.

5. **Tax Competition** – Governments should be encouraged to compete with one another to keep tax rates low and American businesses should not be disadvantaged vis-a-vis their foreign competitors.

6. **States' Rights** – States should be sovereign within their physical boundaries. In addition, the federal government should not mandate that States impose any sales tax compliance burdens.

7. **Privacy Rights** – Sensitive customer data must be protected.

9/18/13 – http://judiciary.house.gov/index.cfm/press-releases?ID=3828FF47-4BE7-4D44-895A-EDB9E27198D8

Conflicts among vendors

Bricks & Mortar

- Treat all sales similarly.
- Technology simplifies compliance.
- States would need to join SSUTA or simplify their sales tax laws.

Remote

- High compliance burden.
- Added audit burden.
- Creates new legal obligations on non-present sellers.

Policy Reponses - Alternatives If Congress Fails to Act

- Improve use tax collection →
- Intermediaries collect
- Supreme Court overruling of *Quill*
- Alternative taxes, e.g., gross receipts taxes, California Commission on 21st Century Economy business net receipts tax proposal

Possibilities for improving use tax collection

- Public awareness campaign and educational activities
- Mandate use of Form 540 or Form 100 to pay use tax
- Specify a penalty for noncompliance
- Clarify and improve the use tax line on Form 540
- Make the use tax law consistent among consumer purchases
  - Repeal R&T §6405 foreign hand-carried goods use tax exemption.
- Require state employees and elected officials to prove compliance
- Pursue technological solutions
- Encourage out-of-state vendors to voluntarily collect use tax or assist in its collection

http://www.21stcenturytaxation.com/uploads/Nellen_UseTax_2013.pdf

Collect use tax pro and con

Pro	Con
Even with MFA, collect when buy from exempted vendor. MFA won't cover foreign sellers.	Easier to get vendors to collect.

Final Observations

Resources

- 114th Congress:
  - S. 698, H.R. 2775
- Affiliate nexus laws
  - http://www.sjsu.edu/people/annette.nellen/website/affiliate_nexus.html
- Streamlined Sales & Use Tax Agreement
  - http://www.streamlinedsalestax.org/
- Dept of Commerce e-stats
  - http://www.census.gov/econ/estats/

Reconciling the Marketplace Fairness Act And Origin Sourcing

by John A. Swain

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In this article, Swain explains the origin-based sourcing plan that has been proposed as an alternative to the Marketplace Fairness Act, points out problems with origin-based sourcing, and offers a solution that exploits the positive aspects of each approach.

In May 2013 the Senate passed the Marketplace Fairness Act of 2013 (MFA), which would have authorized Streamlined Sales and Use Tax Agreement member states to require all remote sellers to collect and remit sales and use taxes, except for sellers with total annual receipts from U.S. remote sales not exceeding $1 million.[1] The MFA also would have allowed a SSUTA nonmember state to require remote sellers to collect and remit sales and use taxes if the state adopted and implemented the MFA's minimum simplification requirements, including providing a single entity within the state responsible for all state and local sales and use tax administration, a single audit and tax return for all state and local jurisdictions, a uniform intrastate sales and use tax base, uniform sourcing rules, free compliance software, and indemnification from reporting errors caused by the compliance software. The legislation failed to progress in the House of Representatives before the 113th meeting of Congress came to a close, but it has been reintroduced in the current session of Congress.[2]

In mid-January 2015 House Judiciary Committee Chairman Bob Goodlatte, R-Va., circulated a discussion draft of legislation that, at first glance, is utterly inconsistent with the MFA.[3] The draft legislation would provide for the origin sourcing of sales of remote sellers that do not have a physical presence in the destination state. Destination sourcing of those sales would be forbidden, as would the imposition of a compensating use tax on the purchaser, but origin states would be required to redistribute the taxes they collect to the appropriate destination states. Tax would be assessed at the origin state rate, but some buyers would be permitted to opt to claim exemptions based on destination state law. Remote sellers based in states that do not impose a sales tax would be required either to disclose purchaser information to taxing authorities in destination states or to collect tax at the lowest sales tax rate among the states that impose sales taxes. A commission would be created to draft a distribution agreement that would govern the administration of the proposed origin-sourcing regime.

The National Conference of State Legislatures and the Multistate Tax Commission responded quickly to the proposal, leveling numerous criticisms. The NCSL complained that it was not included in a meeting of stakeholders who considered the draft proposal before its release. The NCSL also found the proposal unclear, unconstitutional, and riddled with loopholes, and said it "would allow the federal government to dictate state tax policy."[4] It also raised the concern that the proposal would impose a new tax on consumers in no-tax states and a tax hike on consumers in low-tax states. The MTC expressed similar concerns, and objected also that "the bill needlessly perpetuates the distinction between remote sellers and non-remote sellers at the expenses of the states."[5]

This article explains and critiques the origin-sourcing proposal (OSP) and explores whether the OSP is both workable and reflects good tax policy. First, the inherent weakness of origin sourcing is examined. Second, the OSP is briefly explained. Third, selected aspects of the OSP are critiqued. Improvements are suggested when appropriate. This review is not intended to be exhaustive. The focus is on

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[1]S. 743, 113 Cong. (as passed by the U.S. Senate, May 6, 2013).
[2]Marketplace Fairness Act of 2015 (S. 698).
[3]*See* Jennifer DePaul, "Goodlatte Circulates Revised Hybrid Origin-Sourcing MFA Alternative," *State Tax Notes*, Jan. 19, 2015, p. 135.

[4]*See* Maria Koklanaris and DePaul, "NCSL Blasts Goodlatte for Hybrid Origin-Sourcing Proposal," *State Tax Notes*, Feb. 2, 2015, p. 251.
[5]*See* MTC, letter to Rep. Bob Goodlatte and Rep. Anna Eshoo, "Re: Discussion Draft of the Online Sales Simplification Act of 2015," *State Tax Today*, Jan. 26, 2015. *See also* "NGA Says Goodlatte's Origin-Sourcing Proposal for Remote Sales Tax Collection Shows Misunderstanding of Sales Tax," *State Tax Today*, Mar. 9, 2015.

tax policy and not, for example, on issues of state sovereignty or potential constitutional pitfalls. The article concludes by suggesting that the OSP and the MFA work together to bring both simplicity and fairness to the taxation of remote sales.

I. The Inherent Weakness of Origin Sourcing

Water always flows downhill, and dams always leak. That is the problem with origin sourcing. While it has superficial appeal — taxpayers need only comply with one set of tax rules — mobile sellers are motivated to locate remotely from the markets they serve, seeking out low- or no-tax jurisdictions (tax havens) from which to operate. This leads to an inefficient allocation of resources. That is, but for the impact of taxes, it may be more economically efficient for sellers to operate in non-tax-haven jurisdictions and to have a greater presence in the markets they serve. As a consequence of the economic incentive for mobile sellers to seek out tax havens, states cannot rely on origin-based sales and use taxes as a meaningful source of revenue. Origin-based taxes discourage in-state economic activity. Mobility also explains why destination-based sales and use taxes are easier to impose and less distortive. Consumers are less mobile than capital.

> **Water always flows downhill, and dams always leak. That is the problem with origin sourcing.**

The proof is in the pudding. Origin states could tomorrow, without any federal intervention, adopt legislation imposing sales tax on in-state retailers selling to out-of-state consumers. But they won't. In fact, all states that impose a sales tax exclude sales for export from their sales tax base in some manner.[6] Do states ever tax exports? Yes, when the productive activity is not mobile. Natural resources, for example, are subject to severance and other production taxes at the source. It is hard to move a copper mine to Delaware.

Another defect of origin-based sourcing is that it causes sales in the same market to be subject to different rates of tax. As economist William Fox observes, neutrality requires "that all commodities sold in a single market are subject to the same consumption tax."[7]

II. Overview of the OSP

The OSP differs from a pure origin-sourcing regime in that tax is collected by remote sellers in the origin state but is distributed to the destination state. Proponents claim that the OSP's hybrid approach simplifies tax administration while ensuring that destination states receive tax revenue from remote sales. They also assert that imposing some tax on remote sellers is better than the status quo, which imposes no tax. This at least dampens the tax advantage that nonphysically present sellers currently enjoy over their physically present competitors.

It is important to recognize that the OSP does not affect the taxation of sellers that have a physical presence in the destination state, including physically present remote sellers. These sellers will continue to enjoy state-enacted export exemptions and will have a tax collection obligation only in the destination state. The OSP focuses solely on the taxation of remote sellers that do not have a physical presence (as defined by the OSP) in the destination state. To summarize the proposal:

- A state may not impose a tax collection obligation on a nonphysically present remote seller (non-nexus seller) unless the state is both an origin state and a party to the "distribution agreement." An origin state is the state in which the preponderance of the non-nexus seller's employees are located. The distribution agreement is an agreement among the states regarding the administration and distribution of taxes collected by non-nexus sellers.
- The rate of tax shall be the combined origin state and origin locality rate. Origin state exemptions and exclusions will apply as if the sale were fully consummated at the seller's origin state location.
- Provided that a purchaser has paid an origin state tax, the destination state may not impose any additional tax on the purchaser (such as a compensating use tax), except for purchases of vehicles, vessels, or aircraft. (Presumably, a destination state would not be barred from assessing use tax on an item that is exempt under the origin state rules but that is taxable under the destination state rules.)
- Taxes collected by an origin state shall be distributed to the destination state. The destination state shall be determined by reference to buyer delivery or buyer location information provided by the seller. An entity created under the distribution agreement (distribution agreement administrator, or DAA) will serve as the clearinghouse for distributing the tax.
- Persons buying products or services from non-nexus sellers may avoid payment of tax at the origin by either:
  — qualifying for an origin state exclusion or exemption; or
  — issuing a destination state resale certificate, direct pay certificate, or exemption certificate (collectively, "uniform compliant purchaser certificates"). A purchaser who issues a uniform compliant purchaser certificate will generally pay tax or

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[6] *See* Jerome R. Hellerstein, Walter Hellerstein, and John A. Swain, *State Taxation*, para. 18.01 (2015).

[7] William F. Fox, "Can the State Sales Tax Survive a Future Like Its Past?" *in The Future of State Taxation* 33, 41 (David Brunori ed., 1998). *See also* Streamlined Sales Tax Project, "Sourcing Issue Paper" (Jan. 17, 2002). Proponents of the OSP suggest that it fosters beneficial tax competition among the states. *See* Terry Ryan and Eric J. Miethke, "A 'Radical' Solution to the Internet Sales Tax Problem," *State Tax Notes*, July 28, 2014, p. 253, 257. Interjurisdictional tax competition is a complex topic, but clearly, federal legislation that prohibits a state from imposing its consumption tax at a uniform rate promotes unfair competition, not competition in any economically beneficial sense.

enjoy exemptions based on the destination state's rules and rates. A destination state is allowed to establish its own rules governing the authority of purchasers to issue the certificates.

- Non-nexus sellers based in states that do not impose a sales tax must either:
  — report the buyer's name, address, and purchase amount to the DAA; or
  — pay a flat tax to the DAA (for subsequent distribution to the destination state) on each remote sale at a rate equal to the sum of the lowest state rate plus the average local rate in the lowest rate state. In measuring the taxes due, remote sellers based in no-tax states may honor uniform compliant purchaser certificates as well as claims of "common exemptions" as identified by the DAA. This tax regime is hereinafter referred to as the default sales tax, or DST.
- Taxes collected by an origin state on sales to purchasers in a destination state that is not party to the distribution agreement may be retained by the origin state.
- Taxes collected by an origin state on sales to purchasers in a state that does not impose a sales tax may be retained by the origin state, unless the non-sales-tax state is a party to the distribution agreement, in which case the revenue is distributed to the non-sales-tax state.
- Audits of non-nexus sellers may be conducted only by the origin state, except that the distribution agreement may provide for an alternative method for auditing non-nexus sellers based in non-sales-tax states that are not parties to the distribution agreement.
- Disputes over whether a seller is a non-nexus seller or regarding which state is the origin state for a non-nexus seller may be removed to federal court.
- The OSP does not provide a small seller exemption — all non-nexus sellers must collect and pay tax on an origin basis regardless of sales volume.
- For the purpose of determining who qualifies as a non-nexus seller, "physical presence" is defined as:
  — holding certain in-state property interests;
  — having "employees, agents or independent contractors in the state who engage in specific solicitation toward obtaining product or service orders [but] excluding general solicitation campaigns or participation at . . . trade shows and conventions"; or
  — having in-state employees "who provide on-site design, installation, or repair services."

  Further, safe harbors are provided for certain types of short-term physical presence and presence attributable to certain contract delivery services. The OSP also effectively repeals the "Amazon laws" in many states by providing that physical presence "does not include entering into an agreement under which a person, for a commission or other consideration . . . refers potential purchasers to a seller outside the state."
- A state has 30 days from the date of enactment of the OSP to determine whether to participate in the origin-sourcing regime and to designate four representatives to a commission for the purpose of drafting the distribution agreement. The commission then has 90 days to produce the agreement. The agreement then must be approved by both a majority of the states and a yet-to-be-determined federal agency. If the commission does not produce a distribution agreement within 90 days, the OSP's physical presence nexus test becomes the law of the land until a distribution agreement becomes effective.

III. Issues and Concerns

The current draft of the OSP raises a number of issues and concerns. For example, the timetable for producing a distribution agreement is unrealistic, and one might question whether origin states will devote sufficient resources to audits that mainly produce revenue for destination states. Also, the tax avoidance potential of determining a non-nexus seller's origin state based on employee head count merits careful consideration, and the proposed repeal of state Amazon laws bears heavy special-interest fingerprints.[8] Further, Internet shopaholics in low- and no-tax states will be disheartened to learn that the tax rate on purchases from many non-nexus sellers will exceed the local over-the-counter rate. Critics have also raised constitutional concerns, although to the extent the dormant commerce clause is implicated, Congress can probably resolve most issues with the stroke of a pen.

The following discussion focuses on several other troublesome aspects of the OSP, namely, the questionable comparison of the OSP with the International Fuel Tax Agreement (IFTA), the prohibition against the imposition of use tax by destination states, the flexibility given to purchasers in choosing the applicable tax base, the DST, and the definition of non-nexus sellers.

A. Questionable Comparison With IFTA

Proponents of origin-based sourcing claim to draw inspiration from IFTA.[9] The IFTA is a federally mandated tax compliance scheme for collecting fuel use taxes from truckers. Unlike other motorists, who simply pay at the pump,[10] truckers owe fuel taxes to the various states and Canadian provinces based on in-state mileage. Fuel tax rates vary widely from state to state. Under IFTA, truckers select a base state of their choosing to which to report tax. Truckers still pay at the pump, but they then file a reconciling return with

[8]The New York Court of Appeals has upheld the constitutionality of the New York Amazon law. *Overstock.com Inc. v. New York State Department of Taxation and Finance*, 987 N.E.2d 621 (N.Y. 2013), *cert. denied*, 134 S. Ct. 682 (2013).

[9]*See* Ryan and Miethke, *supra* note 7, at 255.

[10]To be more precise, fuel taxes are usually paid at the wholesale level and then built into the price of the fuel.

their base state, reporting their mileage and fuel use tax liability for all states, and either pay any additional tax due or claim a refund. Base states, through a clearinghouse, redistribute tax payments to the states to reconcile the return with what has already been paid at the pump. The trucker may be audited only by the base state.[11]

A key feature of IFTA is that it is solely a streamlined mechanism to ensure one return-one audit. The tax liability for truckers is no different than if they filed individual returns with each state. Thus, for example, there is no tax incentive to choose one base state over another. However, under the OSP, which applies the origin state rate rather than the destination state rate, a non-nexus seller's tax collection obligation could be altered dramatically depending on the rate differential between the origin state and destination state. This creates a strong incentive for non-nexus sellers to relocate to low-tax jurisdictions.

IFTA is about compliance burden relief, not tax relief. Many features of the OSP, however, move the goal posts beyond compliance burden relief to affirmative tax relief.

B. Prohibition Against Use Taxation of Purchasers

The OSP prohibits destination states from collecting any additional use tax owed on purchases from non-nexus sellers (except for purchases of vehicles, vessels, and aircraft). For example, if the origin state sales tax rate is 5 percent and the destination state use tax rate is 8 percent, the OSP would prevent the destination state from collecting the additional 3 percent net use tax due from the purchaser, even though 8 percent is due on identical purchases from all other retailers. There is no justification for providing this competitive advantage to non-nexus sellers. The collection of use tax directly from purchasers imposes no compliance cost on non-nexus sellers. Rather, it merely equalizes the tax cost of purchases, leveling the competitive playing field among retailers making sales to consumers in the destination state market. This is an instance in which the OSP reaches beyond compliance burden relief and grants a substantive tax advantage to many non-nexus sellers.

C. The Non-Nexus Seller Tax Base: Hybrid or Mishmash?

A funny thing happens on the way to origin sourcing. Seller simplicity becomes buyer complexity. In a destination sourcing regime, buyers need only be familiar with their home state tax rules, for example the applicable rate and the available exclusions and exemptions. Under an origin-sourcing regime, however, buyers are confronted with myriad rates and tax base rules. Between sellers and buyers, however, it is sellers who are in a better position to adapt to multistate complexity, because retailing is their business. Buyers — both consumers and businesses — have other preoccupations.

Business purchasers often enjoy home (destination) state exclusions and exemptions, and they would like to continue taking advantage of those tax benefits when purchasing from non-nexus sellers. Thus, the OSP provides that some buyers, namely, those who meet established indicia of trustworthiness as determined by the destination state, may issue resale, direct pay, or exemption certificates (collectively, compliant purchaser certificates) and thus opt to enjoy the tax benefits of their home state when it is advantageous to do so. Other destination state purchasers will not have this option when purchasing from non-nexus sellers (although they can always try to buy from a nexus seller).

More generally, rates, exclusions, and exemptions are all matters of local tax policy preference. They reflect how state legislatures have chosen to tax consumption within the state's borders. Origin sourcing, however, nationalizes each state's rates, exclusions, and exemptions, thus thwarting destination state tax policy: "If my state taxes candy, or remotely accessed software, I'll find a state that doesn't." Of course, destination state use tax may still be due on purchases that were fully exempted from origin state tax,[12] but if collection from purchasers were the answer to the remote sales problem, there would be no need for federal legislation.

D. The Default Sales Tax

The OSP acknowledges the problem of tax havens by requiring non-nexus sellers based in states that do not impose a sales or use tax to either provide purchaser information (allowing destination states to attempt to collect tax from those purchasers) or to pay the DST. The DST rate would be determined by the lowest available sales tax rate nationwide. Presumably, buyers would be able to choose between paying a low tax in lieu of a higher tax or paying no tax and running the audit risk in their home state. Alternatively, to avoid undertaking tax collection and remittance responsibilities, many non-nexus sellers might insist on information reporting only.

The DST is intriguing in that it would be drawn from the law of no particular state, but rather would represent the DAA's delineation of a typical sales tax base, including common exemptions. In other words, the DST would be an embryonic national sales tax. Once again, however, the OSP attempts to preserve a tax advantage for non-nexus sellers. Why adopt the lowest national rate? An average rate would

[11]*See generally* Dwight Denison and Rex L. Facer II, "Interstate Tax Coordination: Lessons From the International Fuel Tax Agreement," 58 *Nat. Tax J.* 591 (2005).

[12]This is the most reasonable reading of the proposal, which prohibits the imposition of destination state use tax only if an origin tax has been paid. In other words, it appears that destination states are not required to honor origin state exemptions, although they are powerless to enlist non-nexus sellers to facilitate tax collection.

be fairer, because, on average, the rate imposed on sales by non-nexus sellers would be the same as that imposed on sales by other sellers.

The DST could be taken a step further. If Congress is going to give a national sales tax a toehold, why not go all in and have the DST apply to all non-nexus sellers nationwide? After all, proponents of the OSP have argued that the primary competitors of Internet sellers are other Internet sellers, and not bricks-and-mortar sellers.[13] While the DST would not apply to nexus Internet sellers, all non-nexus sellers would be subject to the same rate, exemptions structure, and so on. Thus, as among these sellers, the competitive playing field would be level regardless of the state in which a seller is based. This would greatly improve the OSP as now structured, which gives a competitive advantage to non-nexus sellers located in low-tax states and thus encourages economically inefficient migration to tax haven states.

E. Perpetuation of the Antiquated Physical Presence Test

The entire impetus for congressional intervention is the persistence of an anachronistic physical presence test for state tax jurisdiction. We live in a world where large scale remote exploitation of state markets is commonplace. The obvious fix is to require that all sellers collect tax except when the compliance burden is prohibitive. Compliance burden is essentially a function of compliance costs relative to the seller's resources. Sales volume is a far superior proxy for a seller's ability to collect and remit tax on remote sales than is physical presence. Under the physical presence test, we have the absurdity of a seller with $50 million in annual sales volume being treated as unconstitutionally burdened, while a low-volume seller with a single in-state sales representative is not. We also have the absurdity of high-volume sellers straining to avoid physical presence even though physical presence might help them operate more efficiently. A sales volume test avoids this distortion: no business strains to keep sales volume low.

Against this backdrop, the OSP insists on perpetuating physical presence as the touchstone for eligibility to enjoy its simplified and in many respects tax-favored regime. Moreover, the OSP defines physical presence more narrowly than the dormant commerce clause requires, thus enlarging the size of the non-nexus class. This is a step backward. The proper policy goal is to have all sellers competing under the same tax rules, while acknowledging that some sellers may be entitled to exclusion from these rules because of their small size. Sales volume is a far more workable and accurate proxy for identifying these small sellers than is physical presence.

IV. Conclusion

The OSP is deeply flawed. Proponents rely on a dubious comparison with IFTA, but IFTA solely provides compliance burden relief, not tax relief. In contrast, the OSP reaches further to provide direct and indirect tax relief for non-nexus sellers and their customers. Further, the OSP perpetuates the arbitrary and outdated physical presence test — a test that gives large Internet retailers an unfair price advantage, distorts both consumer and seller decision-making, and erodes the state tax base.

In making their case, proponents of the OSP deftly shift attention to the plight of "*small* Internet sellers"[14] and argue that "the bottom line is that the base state approach permits one-stop filing and payment, provides one rate and set of rules for *smaller* remote sellers."[15] Yet the OSP embraces a definition of remote sellers that includes nonphysically present sellers both large and small.

> **The big boys must stop hiding behind the skirts of sellers that truly deserve compliance burden relief.**

This defect is easily corrected. The OSP should apply only to small Internet sellers, which the MFA identifies as sellers with an annual sales volume of less than $1 million. While the MFA would exempt these sellers, the OSP would tax them. Thus, the MFA and the OSP (despite its many flaws) could work together to ensure that all sellers, large and small, collect sales and use tax. Operating in tandem, they would achieve Goodlatte's objective of creating a system that would "render a small business exemption unnecessary." For that to happen, however, the big boys must stop hiding behind the skirts of sellers that truly deserve compliance burden relief. ✰

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[13]Ryan and Miethke, "A 'Radical' Solution to the Internet Sales Tax Problem," *State Tax Notes*, Dec. 22, 2014, p. 677, 681.

[14]Ryan and Miethke, *supra* note 13, at 681 (emphasis supplied).

[15]Ryan and Miethke, *supra* note 7, at 258 (emphasis supplied).