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The State of Texas House of Representatives

WRITTEN TESTIMONY OF JOHN OTTO
STATE REPRESENTATIVE OF HOUSE DISTRICT 18

BEFORE THE

COMMITTEE ON THE JUDICIARY
THE UNITED STATES HOUSE OF REPRESENTATIVES

HEARING ON

CONSTITUTIONAL LIMITATIONS ON STATES' AUTHORITY
TO COLLECT SALES TAXES IN E-COMMERCE

NOVEMBER 30, 2011



Mr. Chairman and members of the committee, thank you for the opportunity to testify today regarding the issue of Constitutional Limitations on States' Authority to Collect Sales Taxes in E-Commerce. My name is John Otto. I am a certified public accountant serving my fourth term in the Texas House of Representatives, where I serve as vice-chairman of the Committee on Ways and Means and as a subcommittee chair on the House Appropriations Committee. I am employed by Ryan, a tax advisory and consulting firm with the largest indirect tax practice in North America. I am pleased today to testify in my capacity as a State Representative.

During the 82nd Legislative Session in Texas this year, I carried legislation to more clearly define the nexus statutes and physical presence. My changes were somewhat conservative compared to what other states were attempting in that I did not include "affiliated marketers" as establishing nexus in Texas, but did address a retailer (including any 50% or more controlled affiliated entity) who had physical presence by means other than a retail store front. The definition included "distribution centers" specifically as constituting physical presence. The legislation was supported by 125 of 150 House members and 30 of 31 Senators. Each state is reacting to the current market place in its own way, but we are constrained at the end of the day by the *Quill* decision.

In 1992, the U.S. Supreme Court opined in *Quill Corp. v. North Dakota* that a retailer does not have an obligation to collect sales tax if they have no "physical presence." Since then, the *Quill* decision has been the law of the land and "physical presence" has been the measuring stick for whether or not a retailer has to collect sales tax. Quoting from the Supreme Court's decision in *Quill* regarding the reasons the justices disagreed with the North Dakota Supreme Court's decision "**This aspect of our decision is made easier by the fact that the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve.**" I believe this opinion shows that the ball is in your court.

Over the last 19 years technology has advanced in the marketplace to the point that physical presence can largely be controlled and isolated to a few states while selling into many states. If action is not taken and *Quill* is allowed to remain the law of the land, then are we not picking winners and losers within the retail sector? How is a retailer, such as Bed, Bath and Beyond, J.C. Penny or Wal-Mart supposed to compete with

Amazon.com, Blue Nile.com or Overstocked.com when the latter enjoy anywhere from an 8-10% discount due to not having to collect sales tax. And all of the companies I have listed as storefront retailers also conduct sales over the internet and currently collect tax on those sales. This current law and policy discourages the continued development of the very brick and mortar establishments that support our state and local communities in numerous ways. This issue of fairness should be addressed and I believe that H.R. 3179 does that.

H.R. 3179, in my opinion, levels the playing field while protecting states' rights. Previous legislation that has been introduced in Congress has contained the requirement that a state join the Streamlined Sales Tax compact in order to receive the benefits of that legislation. While I fully support the rights of states to join the compact, I do not believe a state should be forced into joining the compact in order to receive the benefit of such legislation. As a state representative I am not willing to turn over to an unelected, nonpolitical body the right to determine what items will be subject to sales and use tax within my state. H.R. 3179 leaves it up to each state whether they wish to join the compact or not. Let me also point out that in my opinion the Streamlined states will comply with the requirements of H.R. 3179 as soon as they adopt a small business exemption. So they are at a distinct advantage in regards to how quickly they can implement H.R. 3179.

The provisions of H.R. 3179 basically have four minimum requirements for a state to avail itself of the benefits provided in this legislation:

1. Small business exemption
2. Uniform tax base rules within a state – what is and is not taxable
3. Centralized filing and remitting within a state
4. Tax rates: Either -
 - State rate only (not local)
 - Blended rate – state and partial local rates
 - Address-based rate with software made available

In my opinion the requirement for a uniform tax base within a state (which is desirable) may cause delays in implementing the provisions of H.R. 3179 for some states, unless the tax rate options are included in the final legislation. In Texas, locals may tax residential electricity and may not impose tax on interstate telecommunications services and satellite television services. Some other states may have similar situations in which locals may impose their tax on something the state does not (example: Chicago's tax of soft drink cans).

Also, some states permit locals to “opt out” of sales tax holidays and this proposal would appear to preclude that. One solution, to all of the issues just discussed, is for a state to adopt the state only rate or blended rate and have it apply to the state definitions of what is taxable. Because H.R. 3179 requires uniform tax base rules, this needs to be clarified in the final legislation that the uniformity of state and local would only apply should the state choose an address based rate with software made available. The bill also states that local taxing jurisdictions cannot require remote sellers to file returns which may affect states like California, Arizona, Louisiana and Colorado, unless they adopt the state rate only or blended rate. I cannot overemphasize how important I believe it is that the final legislation include all three of the proposed methods of taxation. Adopting the addressed-based rate with software made available as the only method available to states will have a significant impact on which states can participate and how quickly they can comply.

Finally, let me address the revenue side of the equation as it relates to state governments. I know some people will call this a new tax, but it is not. This is a tax that has been due from the consumer, when the retailer is not required to collect it, since sales and use taxes were put into law. Businesses for the most part are already paying the use tax because they are subject to audit if they hold a sales tax permit. With the ever increasing likelihood that states are going to find lesser amounts of federal revenues available to them as you attempt to reduce federal spending, wouldn't it make sense to allow states to have retailers collect a tax that is already in law? Before I vote to increase a state sales tax rate that would only increase the current disparity between local and out of state retailers, it only makes sense to first collect the taxes states are already due. H.R. 3179 helps states accomplish that.

Thank you Mr. Chairman and members of the committee for allowing me to testify today. I would now be happy to answer any questions you might have.