

Testimony of Stephen P. Kranz
United States House of Representatives
Committee on the Judiciary
March 12, 2014

Testimony of
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Before the
Committee on the Judiciary
Of the
United States House of Representatives

Hearing on
Exploring Alternative Solutions on the Internet Sales Tax Issue

March 12, 2014

I. Introduction

Chairman Goodlatte, Ranking Member Conyers, members of the Committee on the Judiciary, I am Stephen Kranz, a Partner at the law firm of McDermott Will & Emery in the firm's Washington, D.C. office, and a member of its State and Local Tax Practice Group.¹

I am honored by the Chairman's invitation to testify today. I have spent most of my professional career dealing with state and local tax issues and welcome the opportunity to share my views with the Committee.

Prior to entering private practice I served as the General Counsel to the Council On State Taxation (COST), a trade association that represents the interests of more than 600 of the nation's largest taxpayers on issues of state and local taxation. I started my career as a tax litigator for the U.S. Department of Justice. Since then I have focused entirely on state tax matters and in particular the issues surrounding taxation of sales made over the Internet.

With respect to the issue before the Committee today, my role at COST allowed me to participate in the Congressionally-organized Advisory Commission on Electronic Commerce and to represent the COST membership in the Streamlined Sales Tax Project and Implementing States. I helped found, and served as the President of, the Business Advisory Council to the Streamlined Sales Tax Governing Board, and I now sit as an *ex officio* member of the Governing Board itself. My role as an advocate for simplification, uniformity and a national framework to address this issue spans more than 15 years. Outside of this issue I help companies large and small understand, comply with, and, when warranted, contest state and local tax laws.²

II. Summary

Since *Quill v. North Dakota* was decided in 1992, remote sales have risen significantly both in absolute dollars and as a percentage of total sales. Although catalog sales have long been

¹ I note with great pride that Quill Corporation was represented in its suit against North Dakota before the U.S. Supreme Court by John E. (Jack) Gaggini, a partner at McDermott Will & Emery, who spent 37 years handling state tax litigation before he retired in December of 2013. *Quill Corporation v. North Dakota*, 540 U.S. 298 (1992).

² I note that my testimony today consists of my opinions and thoughts on this issue. None of my statements are made on behalf of my firm or any of my clients or clients of my firm.

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part of the American retail system and have always raised sales tax issues,³ the rise of the Internet has drastically changed the face of commerce. As members of this committee know, in *Quill*, the U.S. Supreme Court reaffirmed the rule that a state may not require remote sellers to collect sales tax⁴ unless the remote sellers have physical presence in the state. As commerce continues to shift to the Internet, states have looked for ways to force remote sellers to collect tax, despite the Court's holding. Although one of the hallmarks of our federal system is to allow states to experiment with different ways to govern themselves and raise revenue, in this case the states have in some cases adopted wildly divergent, contradictory and burdensome laws that have harmed businesses and imposed an undue burden on interstate commerce. As the U.S. Supreme Court noted in *Quill*, Congress is expressly authorized to deal with this problem, and is better qualified to deal with this problem than the courts.

Congress has two choices regarding how it will react to the problems of collecting sales tax on remote sales: Congress can either (1) exercise its authority under the Commerce Clause to provide a framework under which states can enforce collection by remote sellers, or (2) Congress can do nothing. There is no question that states will continue to try forcing remote sellers to collect their sales taxes regardless of Congress' action or inaction. The question is whether Congress will provide the necessary framework to ensure that state collection efforts will be uniform, clear, predictable and fair or, in the alternative, Congress will remain silent and allow state collection efforts to be confusing, unpredictable, burdensome, and potentially discriminatory.

A radical departure from the existing sales tax regimes is not needed. Businesses, commerce, consumers and, perhaps most important, the United States economic system would be greatly enhanced if Congress were to fix the problem by exercising its Commerce Clause authority and provide a uniform structure for the state enforcement of sales tax collection on remote sales, a structure that will provide the simplifications, technology, and protections needed to eliminate any undue burden.

³ *Nelson v. Sears, Roebuck & Co.*, 312 U.S. 359 (1941); *Nelson v. Montgomery Ward & Co.*, 312 U.S. 373 (1941).

⁴ I use the term "sales tax" to include both the sales tax and the complimentary use tax.

III. Congressional Inaction Has Resulted in Burdensome State Self-Help

In the past decade, individual states have adopted aggressive, dissimilar, and burdensome laws attempting to impose sales tax collection obligations on remote sellers. Although twenty-four states⁵ have implemented simplification provisions under the Streamlined Sales and Use Tax Agreement, Congress has shown no inclination to reward those states for their efforts, and *Quill* still prevents the states from imposing sales tax collection obligations on remote sellers. If Congress does not overturn the *Quill* physical presence requirement and establish a framework for imposition of collection obligations on remote sellers, states will undoubtedly continue taking action that is constitutionally questionable, creates additional burdens on remote sellers, and invites litigation.

A. Historical Efforts to Simplify

The *Quill* physical presence requirement goes back at least as far as 1967, when the U.S. Supreme Court decided *Bellas Hess* and established the rule underlying the *Quill* decision.⁶ In 1973 Congress introduced the first legislation seeking to eliminate the physical presence rule.⁷ Since then no fewer than twenty-five bills have been introduced in Congress to address the issue.⁸ None of these efforts have been successful. In the absence of a federal solution states

⁵ The full member states are: Arkansas, Georgia, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, Nevada, New Jersey, North Carolina, North Dakota, Ohio, Oklahoma, Rhode Island, South Dakota, Utah, Vermont, Washington, West Virginia, Wisconsin, and Wyoming. Tennessee is an associate member. <http://www.streamlinedsalestax.org/index.php?page=state-info> (last visited Feb. 27, 2014).

⁶ *National Bellas Hess, Inc. v. Department of Revenue of Illinois*, 386 U.S. 753 (1967).

⁷ Interstate Sales and Use Tax Act, S. 282, 93d Cong. (1973).

⁸ See Marketplace Fairness Act, S. 743, 113th Cong. (2013); Marketplace Fairness Act, S. 1832, 112th Cong. (2011); Marketplace Equity Act of 2011, H.R. 3179, 112th Cong. (2011); Main Street Fairness Act, S. 1452, 112th Cong. (2011); Main Street Fairness Act, H.R. 2701, 112th Cong. (2011); Main Street Fairness Act, H.R. 5660, 111th Cong. (2010); Sales Tax Fairness and Simplification Act, H.R. 3396, 110th Cong. (2007); Sales Tax Fairness and Simplification Act, S. 34, 110th Cong. (2007); Streamlined Sales Tax Simplification Act, S. 2153, 109th Cong. (2005); Sales Tax Fairness and Simplification Act, S. 2152, 109th Cong. (2005); Streamlined Sales and Use Tax Act, S. 1736, 108th Cong. (2003); Streamlined Sales and Use Tax Act, H.R. 3184, 108th Cong. (2003); Internet Tax Moratorium and Equity Act, S. 1542, 107th Cong. (2001); Internet Tax Moratorium and Equity Act, S. 2775, 106th Cong. (2000); Fair and Equitable Interstate Tax Compact Simplification Act of 2000, H.R. 4462, 106th Cong. (2000); Internet Tax Simplification Act of 2000, H.R. 4460, 106th Cong. (2000); Consumer and Main Street Protection Act of 1995, S. 545, 104th Cong. (1995); Tax Fairness for Main Street Business Act of 1994, S. 1825, 103d Cong. (1994); Equity in Interstate Competition Act of 1989, H. R. 2230, 101st Cong., 1st Sess. (1989); Equity in Interstate Competition Act of 1989, S. 480, 101st Cong., 1st Sess. (1989); Main Street Fair Competition Act of 1988, S. 2368, 100th Cong., 2d Sess. (1988); Equity in Interstate Competition Act of 1987, H. R. 3521, 100th Cong.,

have been working to solve the issue on their own. In 1999 Utah Governor Michael O. Leavitt asked the states to begin an effort to simplify their sales tax regimes to address the remote seller question. In March of 2000 the states held the first meeting of the Streamlined Sales Tax Project, an effort aimed at reducing the sales tax collection burden such that Congress would reward the states by giving them collection authority or that the states themselves could feel comfortable that their sub-national sales tax regime no longer imposed an undue burden on interstate commerce, therefore satisfying the *Quill* standard (even though the Supreme Court's *Quill* opinion states that such an imposition requires physical presence). Over the last 15 years, the Streamlined Sales Tax Project gave rise to the Streamlined Sales Tax Implementing States which gave rise to the Streamlined Sales and Use Tax Governing Board which oversees state implementation and participation in the Streamlined Sales and Use Tax Agreement ("SSUTA"). Each iteration of the effort has involved collaboration between states, local governments, main street retailers, and online retailers. While not all involved were supportive of the effort, the SSUTA attempted to develop a rational set of rules that, if applied to remote commerce, would reduce the burden of tax collection. Even today, additional states are considering legislation to become part of the SSUTA effort.⁹

In 2001, the first piece of legislation that would reward the SSUTA member states with an overturn of *Quill* was introduced in Congress.¹⁰ In every session of Congress since then, similar legislation has been considered.¹¹

1st Sess. (1987); Equity in Interstate Competition Act of 1987, S. 1099, 100th Cong., 1st Sess. (1987); H. R. 3549, 99th Cong., 1st Sess. (1985); Interstate Taxation Act of 1979, S. 983, 96th Cong., 1st Sess. (1979).

⁹ See, e.g., H.B. 857, 2014 Leg. (Fla. 2014); H.B. 2135, 27th Leg. (Haw. 2014). H.B. 1477, 1654 and 1721, 97th Gen. Assem., 2nd Reg. Sess. (Mo. 2014).

¹⁰ See Internet Tax Moratorium and Equity Act, S. 1542, 107th Cong. (2001).

¹¹ See, e.g., Marketplace Fairness Act, S. 743, 113th Cong. (2013); Marketplace Fairness Act, S. 1832, 112th Cong. (2011); Main Street Fairness Act, S. 1452, 112th Cong. (2011); Main Street Fairness Act, H.R. 2701, 112th Cong. (2011); Main Street Fairness Act, H.R. 5660, 111th Cong. (2010); Sales Tax Fairness and Simplification Act, H.R. 3396, 110th Cong. (2007); Sales Tax Fairness and Simplification Act, S. 34, 110th Cong. (2007); Streamlined Sales Tax Simplification Act, S. 2153, 109th Cong. (2005); Sales Tax Fairness and Simplification Act, S. 2152, 109th Cong. (2005); Streamlined Sales and Use Tax Act, S. 1736, 108th Cong. (2003); Streamlined Sales and Use Tax Act, H.R. 3184, 108th Cong. (2003).

The SSUTA itself seeks to reduce the burden of collection by requiring its participating states to adopt uniform definitions and administrative rules and by also providing commercial software that is certified for use in the tax collection process. SSUTA does not dictate what is taxable or the tax rates; it leaves those decisions to the sovereign states. The SSUTA has many other provisions too numerous to detail here, such as a centralized registration system, a uniform tax return, and a uniform rounding rule, all of which seek to reduce disparity among the states while respecting their sovereignty.

Although the SSUTA effort has improved tax collection practices and uniformity, it has not led to Congressional action. States, whether members of SSUTA or not, have responded to the lack of federal involvement by pursuing alternatives to SSUTA in an effort to expand their jurisdiction over remote sellers. The alternatives, while demonstrating creativity, push the edge of constitutional limits and cause increasing problems for all businesses.

B. Inconsistent and Unpredictable State-by-State Action to Address Collection Problem

In the last decade, states have enacted at least three types of legislation as self-help to address the lack of a federal solution.¹² The three types of legislation include: (i) click-through nexus legislation; (ii) use tax reporting legislation; and (iii) unilateral “*Quill* is dead” legislation.

1. Legislation

a. Click-through nexus laws

A click-through nexus law was first passed by New York in 2008¹³ and at least twelve states¹⁴ have subsequently enacted laws with similar approaches, but with slightly different terms and applicability. These laws typically provide that in-state website operators create a sales tax

¹² Efforts are underway by the Multistate Tax Commission (“MTC”) to draft yet another version of nexus-expanding legislation, even in the face of ongoing litigation over the validity of such legislation. See the MTC’s Sales and Use Tax Nexus Model Statute Project, <http://www.mtc.gov/Uniformity.aspx?id=5890> (last accessed March 2, 2014).

¹³ N.Y. Tax Law § 1101(b)(8)(vi).

¹⁴ See Ark. Code Ann. § 26-52-117; Cal. Rev. & Tax. § 6203(c)(5); Conn. Gen. Stat. § 12-407(a)(12)(L); Ga. Stat. Ann. § 48-8-2(8)(M); 35 ILCS §§ 105/2 and 110/2; Kan. Stat § 79-3702(h)(2)(C); Me. Rev. Stat. Ann. § 1754-B(1-A)(C); Minn. Stat. § 297A.66, Subd. 4a; Mo. Rev. Stat. § 144.605(2)(e); N.Y. Tax Law § 1101(b)(8)(vi); N.C. Gen. Stat. § 105-164.8; R.I. Gen. Laws § 44-18-15; Vt. Stat. Ann. tit. 32, § 9701(9)(I) (H.B. 436).

collection obligation for remote sellers if all operators in the state collectively refer a threshold amount of sales (usually \$10,000 over a calendar year) to the remote seller through links on their websites and are paid by commission. Once the obligation is triggered, the seller must collect tax on all sales into the state, not just on the sales resulting from the website operators' referrals.

The click-through legislation attempted to work within the framework set by *Quill*, in that it was an attempt to further define what physical presence consisted of in a state, in this case, that in-state web operators created physical presence for remote sellers. However, the precedent set by this legislation is somewhat disturbing in that it targeted an innovative marketing arrangement that helped compensate self-made bloggers and website operators which very often are small businesses and startups. The response by remote sellers in some jurisdictions was to end these marketing arrangements, harming an important nascent industry. The click-through legislation clearly demonstrates what happens without a Congressional framework, in that states undermine, or at least add burdens to, creative business ideas unique to remote sellers and impose tax obligations based on those ideas without any accompanying reforms to simplify the tax law or protect businesses.

b. Use Tax Reporting Requirements

The next evolution in anti-*Quill* legislation did not even attempt to work within the framework of *Quill*, and instead attempted an end-run around the case. Use tax reporting requirements were first passed by Colorado in 2010¹⁵ and at least four states¹⁶ subsequently enacted similar laws, again with varying terms and scope. The use tax reporting legislation was an attempt to address the issue of collecting use tax from consumers. As members of this committee are aware, the question of sales tax collection by remote sellers is not a question of whether the tax is owed or not, but rather whether the remote seller is required to collect the tax from the consumer. Under state sales and use tax laws, the consumers still owe the tax, though enforcement of that liability against individual consumers is extremely difficult.

¹⁵ Colo. Rev. Stat. § 39-21-112(3.5)(d).

¹⁶ Ky. Rev. Stat. Ann. § 139.450; 68 Okla. Stat. § 1406.1; S.C. Code Ann. §§ 12-36-2691(E), -2692; S.D. Codified Laws § 10-63-2.

The use tax reporting laws are purportedly designed to give states the tools and information needed to collect the use tax from consumers. The laws require remote sellers to provide a number of tax notifications and reports to their consumers and the states, and impose penalties if those notifications and reports are not filed. For example, Colorado's law requires notifications to be provided to consumers regarding the consumers' use tax obligations each time sales are made, as well as annual reports to be provided to consumers and to the state setting forth the amount of taxable products sold to consumers during the course of the preceding year. In reality, although the law might appear to be designed to gather information on consumers for purposes of enforcing use tax, in practice it makes compliance so onerous that companies will simply surrender their constitutional right and begin collecting sales and use taxes rather than dealing with the reporting requirements.¹⁷

c. “*Quill* is Dead” Legislation

If click-through legislation attempted to work within the *Quill* framework and use tax reporting legislation attempted to bypass the *Quill* framework, then the third type of anti-*Quill* legislation attempts to run through *Quill* as if it no longer exists. In 2010, Oklahoma passed legislation that listed all of the steps it had taken to simplify its sales and use tax system, and declared that its tax system no longer presented an “undue burden” on interstate commerce and that any and all remote sellers are required to collect sales and use tax on sales made into the state.¹⁸

As background, under the U.S. Supreme Court's “Dormant Commerce Clause” jurisprudence, absent specific Congressional action a state may not take action that imposes an undue burden on interstate commerce.¹⁹ Under *Quill* and related decisions, the U.S. Supreme Court has held that the imposition of a sales and use tax collection obligation on remote sellers

¹⁷ Even Phil Horwitz, the Colorado Department of Revenue's tax policy director said he “thinks most retailers would simply choose to collect the tax to avoid the more unpleasant option of having to send tax notices to their customers.” Colleen Slevin, *Colorado Considers New Tactic to Tax Online Sales*, The Denver Post, February 8, 2010, available at http://www.denverpost.com/ci_14359737.

¹⁸ 68 Okla. Stat. § 1407.5.

¹⁹ See, e.g. *Quill Corp.*, 540 U.S. at 305-6.

with no physical presence was such an undue burden. Under its 2010 legislation, Oklahoma has declared that its sales and use tax law is so simple that sales tax can be imposed on any interstate sales without creating an undue burden. This is, of course, unconstitutional because the Supreme Court has routinely held that taxation of remote sellers requires physical presence.²⁰ Under *stare decisis*, the imposition of Oklahoma's sales tax collection obligation on remote sellers is unconstitutional, even if it had the simplest sales tax in the world. Furthermore, the U.S. Supreme Court's decision in *Quill* was based on the complexity inherent in complying with differing rules in multiple jurisdictions; a single state cannot unilaterally simplify a multistate system.

Fortunately, Oklahoma has not yet attempted to enforce this law. Unfortunately, Oklahoma is not the only state that could take this position. Oklahoma is one of twenty four SSUTA member states. Oklahoma's statutory claim is based, in part, on its implementation of simplification provisions under the SSUTA. Other states that are parties to the Agreement could similarly argue, even without a relevant statute, that their sales and use tax regimes do not create undue burdens on interstate commerce.

State tax policy discussions of late have included observations regarding states pursuing a strategy of assessing and litigating. If no federal framework is adopted it should come as no surprise when the SSUTA states collectively act as if *Quill* is no longer a restriction. Remote sellers facing assessment by twenty-four states with similar statutes will be forced to either commence litigation or surrender their constitutional rights and begin collecting tax on remote sales. Non-SSUTA states could also take the position that their sales tax is "simple enough" and begin assessing remote sellers. Only Congressional action can prevent the parade of horrors that would follow. If Congress does not act there will be little protection for businesses and much of the American economy: no guarantee of protection from aggressive audits; no provision requiring certification of commercial software as able to assist in collecting tax for all states; and

²⁰ Stephen P. Kranz, Lisbeth A. Freeman, Mark W. Yopp, *Is Quill Dead? At Least One State Has Written the Obituary*, 2010 STT 147-1, pp. 307-11 (August 2, 2010).

nothing to prevent the states from rolling back the simplifications that have already been achieved.

2. Aggressive State Policy and Remote Seller Audit Risk

Outside of the legislative arena, many state revenue agencies take aggressive policy and audit positions regarding what activity meets the *Quill* physical presence test. These positions are often not documented or set forth in written guidance, which makes it easy for states revenue agencies to adjust and modify these positions as needed to fit them under existing statutes. For example, a revenue authority in a state that has not expressly adopted click-through nexus legislation may nevertheless take the position that general case law is sufficient to require click-through based collection. Such ad hoc policy and audit decisions catch both large and small vendors in the compliance and liability risk net and cause confusion for consumers.

The Bloomberg BNA Annual Survey of State Tax Departments contains examples of the theories that various state tax departments have considered when arguing a remote seller has nexus, even in the absence of an explicit statutory provision.²¹ The Survey demonstrates the varied, inconsistent, and confusing positions taken by states, compounding the burden on remote sellers. For example, Florida says that selling gift cards in the state creates nexus, while Texas does not. On the other hand, Texas says that a remote seller has nexus if it attends a trade show in the state, even if no sales are made at the show and no orders are taken, but Florida says that trade show activity does not create nexus.²² Facing the possibility that it may have liability for failing to collect tax under these wildly inconsistent and varied theories, what should a remote seller do?

²¹ Bloomberg BNA, *2013 Survey of State Tax Departments* as Management Multistate Tax Report, Vol. 20, No. 4 (April 26, 2013).

²² *Id.* A perusal of the survey exposes many additional views on what constitutes nexus-creating activity. Some states have indicated in the survey response that the following activities create a sales tax collection requirement for remote sellers: making “sales to customers in [the] state by means of an 800 telephone order number and advertis[ing] in [the] state”; “the corporation is listed in the local telephone books of cities in [the] state”; “maintaining a bank account in the state”; and “the corporation makes remote sales into [the] state and hires a third party to post informational content on in-state websites or blogs.”

C. *Consequences of Congressional Inaction and State-Specific Legislation*

If Congress does not act, states will surely continue to pursue constitutionally suspect attacks on remote sellers. This trend will accordingly cause increasing problems and burden on business. First, the threat of assessment and litigation results in uncertainty, audit exposure, and direct cost to business and much of the American economy. Second, the evolution and disparity in state approaches makes it nearly impossible for businesses to understand their tax obligation. Finally, consumers will face a growing risk of state use tax enforcement.

1. Increased Litigation

The states' varying responses to the sales tax collection problem for remote sales have generated, and will continue to generate, a significant amount of litigation. Remote sellers are at an inherent disadvantage in litigating these issues. This litigation creates significant costs for those who choose to fight and creates significant uncertainty for all businesses while the litigation and any subsequent appeals are ongoing.

The click-through nexus laws have been challenged in New York and Illinois. In New York, two companies, Amazon.com and Overstock.com,²³ litigated the validity of the law and lost in the New York Court of Appeals (New York's highest court), and were turned away by the U.S. Supreme Court when it denied a petition for certiorari. In so doing, the U.S. Supreme Court implicitly reaffirmed its long-held position on this matter: it has addressed the issue twice, in *Bellas Hess* and again in *Quill*, and any additional action should be taken by Congress. The court in Illinois on the other hand held in favor of remote sellers and invalidated a similar, yet different, law.²⁴ Given the uncertainty and the possibility of inconsistent decisions in many states over the validity of similar laws, what should remote sellers do?

The use tax reporting laws have also led to litigation. In Colorado, the Direct Marketing Association (DMA) filed suit in federal court challenging the reporting regime. The DMA was

²³ *Overstock.com, Inc. v. New York State Dept. of Tax. and Fin.*, 987 N.E.2d 621, 20 N.Y.3d 586 (2013), *cert. denied* 134 S.Ct. 682 (2013).

²⁴ *Performance Marketing Association v. Hamer*, 998 N.E.2d 54, 375 Ill.Dec. 762 (2013).

successful in obtaining an injunction against the law from the federal district court, but the Tenth Circuit ruled that federal courts did not have authority to hear the case.²⁵ The DMA subsequently re-filed the case in state court and obtained an injunction at the state court level.²⁶ The state court litigation and a potential appeal of the Tenth Circuit decision are ongoing. This litigation has taken more than three years so far with no resolution apparent in the near term. In the meantime, every decision by a court has required vendors to determine whether they need to start complying with the law and how fast such compliance must be accomplished. Compliance requires significant system changes to collect and turn over the data required by statute; it is not merely flipping a switch.

If Congress continues to allow states to act with no guidance, states can, and ultimately will, continue to enact legislation and adopt policies that will seek to require remote sellers with limited resources to collect sales tax. Not everyone has the resources to challenge the constitutionality of such legislation and policies. The result will be more litigation, more costs for those that cannot litigate, and more uncertainty for everyone.

2. Increasing Uncertainty for Remote Sellers and Consumers

The absence of Congressional action addressing sales tax collection obligations on remote sellers is resulting, and will increasingly result, in frustrating uncertainty for remote sellers and consumers. The areas in which this uncertainty will manifest are myriad. For example, as noted above, the Colorado use tax reporting regime litigation has led to repeated questions as to when and if remote sellers must start complying. The same can be said of the click-through legislation. Their scope, applicability, and constitutionality are the subject of weekly client inquiries, from companies large and small, seeking to know whether they have tax obligations that must be met. There are rarely easy answers to such questions and the uncertainty inevitably inhibits business decision making and expansion and imposes unpredictable audit exposure.

²⁵ *Direct Marketing Assoc'n v. Brohl*, 735 F.3d 904 (10th 2013).

²⁶ *Direct Marketing Assoc'n v. Colo. Dept. of Rev.*, Col. Dist. Ct.-Denver, Dkt. 13CV34855 (Feb. 18, 2014).

Consumers are also harmed by the lack of clarity regarding their tax obligations. While legally it is clear that consumers owe tax on purchases when the seller does not collect tax at the time of sale, consumers often do not understand that they are not following the law by failing to remit such tax. Those that try to comply are faced with a complicated, time consuming, and inefficient task – tracking all of their purchases where tax was not collected, determining whether each item purchased was in fact taxable, determining the appropriate tax rate, calculating and remitting the proper amount of tax. Tax friends of mine keep spreadsheets of their individual purchases to do the math. It’s absurd that in today’s modern economy we don’t have an App for that. In reality, we do have a solution, and it is being used by companies that collect tax today, but without a uniform requirement of collection, consumers are faced with the tax calculation burden.

Without Congressional intervention in the issue consumers also face a growing risk that their personal information will be the subject of government inquiry. While states today do not routinely audit consumer buying to determine whether tax was paid, states have the authority to do so. Whether obtained by auditing an individual or, as in the case of Colorado, by mandating that sellers disclose their consumers and their consumers’ purchases, it is clear that consumer information we all expect to be kept private is considered necessary by states for their use tax enforcement efforts. Consumer privacy should not be allowed to be imperiled by states driven to action in the absence of a federal solution.

IV. Congressional Action Is Needed to Protect Businesses, Consumers, and the States

In addition to avoiding the problems identified above, Congressional action establishing a framework for collection of state and local sales tax within the existing sales tax system would promote additional important policy benefits. One of those benefits is the preservation of state sovereignty. Another benefit is that Congress can create a framework designed to ensure that remote sellers have the information and certified commercial software needed to comply with all states sales tax laws, thus keeping the burden of tax compliance from being placed on consumers. Despite what some have argued, the technology and software that is available today

offers remote sellers the ability to collect and remit sales and use taxes in an efficient, seamless manner.

A. Preservation of State Sovereignty

Forty-five states have made the sovereign choice to fund government by imposing a sales tax on consumption by their residents. As Internet sales continue to erode the sales tax base, those states that have relied on a consumption tax regime are at risk of losing the ability to continue that policy choice. To maintain even a steady level of funding, states are being forced to rely instead on taxing income and property.

As Congress considers whether to act to address the issue of sales tax collection by remote sellers, some states have passed legislation that is at least partially contingent on revenue that would arise from federal legislation to overturn *Quill*.²⁷ For instance, in 2013 Virginia enacted a transportation funding bill that, among other actions, altered the state's tax on fuel. If federal legislation is not enacted to enable sales tax collection from remote sellers by January 1, 2015, then there is an automatic increase to the Virginia fuel tax rate. The 2013 Ohio and Wisconsin budget bills would direct revenue received as a result of federal legislation to reduce those states' income taxes. A bill is currently pending in the Idaho House of Representatives that would fund a tax relief fund with tax collected as a result of passage of the Marketplace Fairness Act.²⁸ In 2013, a Utah bill was enacted that would create a restricted account for sales tax revenue from remote sellers, and provides that the legislature may reduce local and state sales and use tax rates based on the revenue collected in the account.²⁹ Furthermore, in other states, state legislators have proposed similar bills³⁰ and governors³¹ are signaling that they would use

²⁷ H.B. 1515, 2013 Gen. Assem., Reg. Sess. (Md. 2013) (enacted); H.B. 59, 130th Gen. Assem., (Ohio 2013) (enacted); H.B. 2313, 2013 Gen. Assem. (Va. 2013) (enacted); A.B. 40, 2013 Leg., (Wis. 2013) (enacted).

²⁸ H.B. 593, 62nd Leg., 2nd Reg. Sess. (Idaho 2014).

²⁹ S.B. 58, 2013 Leg., Gen. Sess. (Utah 2013) (enacted).

³⁰ H.B. 2465, 51st Leg., 2nd Reg. Sess. (Ariz. 2014); H.B. 2730, 2014 Leg., 2014 Sess. (Kan. 2014); H.B. 137, 2014 Leg., Reg. Sess. (Ky. 2014); S.B. 1424, 108th Gen. Assem. (Tenn. 2014); H.B. 224, 2014 Leg., Gen. Sess. (Utah 2014); H.B. 218, 2014 Leg., Gen. Sess. (Utah 2014). Note that as of this writing, the Arizona bill and Utah H.B. 224 failed to pass their respective legislative bodies.

³¹ The governors from Iowa, Maine, and Rhode Island have all indicated they intend to reduce taxes once their states receive revenue from sales tax imposed on remote sales. See <http://thehill.com/blogs/on-the-money/domestic->

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revenue from federal legislation to decrease taxes. In particular, Tennessee Governor Bill Haslam, along with Tennessee House Speaker Beth Harwell and Tennessee Senate Speaker Ron Ramsey, have expressed support for the Marketplace Fairness Act and indicated that the revenue generated from federal legislation would be used to reduce current state taxes.³²

Only Congress can prevent the erosion of the states' sovereign ability to make tax policy decisions by creating a framework for sales tax collection in the modern era. In creating a framework for sales tax collection Congress should similarly shy away from those alternatives that would cause a radical departure from existing state consumption tax systems. Some of the proposals you will hear today would trample state tax policy decisions put in place by Legislatures and Governors in each state and have far-reaching economic impacts.

Origin sourcing, with or without a redistribution compact, turns our state consumption tax system into a tax on production and suffers from constitutional infirmity. A 1099-style reporting regime for consumer purchases threatens consumer privacy in a manner that I hope you find as unappealing as the option of banning interstate commerce altogether. These are not alternative solutions to the Internet sales tax issue – they are proposals that would undermine state sovereignty and wreak havoc on business and consumers alike.

Congress' role under its Commerce Clause authority should acknowledge and preserve state sovereignty. Only by affirmatively addressing the remote sales tax authority question can Congress sustain the ability of states – like Texas, Tennessee, Florida, South Dakota, and Washington – to choose to rely on the sales tax so heavily. Without it those states should be preparing to impose an income tax.

[taxes/305223-iowas-gop-governor-lobbies-for-online-sales-tax-bill](#) (last visited March 9, 2014) and <http://www.rila.org/news/topnews/Pages/TheMarketplaceFairnessActIsPro-GrowthLegislation.aspx> (last visited March 9, 2014); Letter from Gov. Branstad to Rep. Steve King (June 12, 2013) available at <http://www.standwithmainstreet.com/getobject.aspx?file=lettertohousedelegation>; Letter from Gov. LePage to Sens. Snowe and Collins (Mar. 12, 2012) available at <http://www.standwithmainstreet.com/getobject.aspx?file=Lepage>.
³² *Marketplace Equity Act of 2011: Hearing Before the Comm. On the Judiciary, House of Representatives, One Hundred Twelfth Congress, Second Session on H.R. 3179*, 112th Cong. (2012) (statement of The Honorable Bill Haslam, Governor of Tennessee, on behalf of the National Governors Association); Tom Humphrey, *Passage of Marketplace Act May Lead to Lower State Taxes in Tennessee*, KnoxNews, June 3, 2013, available at <http://www.knoxnews.com/news/2013/jun/03/passage-of-marketplace-act-may-lead-to-lower-in/?print=1>.

B. Creation of Congressional Framework

I applaud the principles issued by the Chair that provide guidance related to the imposition of tax on remote sales. Those principles outline a path for Congress to create a workable framework for collection of sales tax. By acting to establish a framework, Congress can ensure not only that state laws as applied to remote sellers do not become overly complicated, but also that states are required to give remote sellers the tools they need to comply with those laws.

A framework is needed. A framework that provides certainty to business, consumers, and the states. A framework that relies on state-provided information, certified commercial software, and protections for business. A framework that preserves state sovereignty. And, perhaps most important, a framework that protects the American economy and American jobs. All of these are achievable, and only by Congress.

V. **Alternative Proposals**

Below I briefly address each of the alternative solutions proposed today to address the Internet sales tax issue. Additional thoughts on some of the alternative proposals and other concepts related to the remote collection issue can be found in the Appendix to this testimony.

A. Option 1: SSUTA-Type Compact Governing Interstate Transactions Only

The only viable alternative being discussed today is one in which Congress creates a federal framework to address the Internet sales tax issue based on a compact among the states but which leaves intact the general ability of states to decide whether, and on what, to impose a sales tax. Whether that compact ties directly to the existing Streamlined Sales and Use Tax Agreement or offers a different set of simplifications, and whether the solution applies only to remote sales or to all sales are questions Congress can and should address. The question as to what are the best details of such a compact, however, does not alter the inherent reasonableness of adopting a system that provides simplification and protection to remote sellers, protection of states' revenue streams, and continued recognition of state sovereignty.

B. Option 2: Multistate Compact to Collect & Redistribute Sales Tax

You have been presented with a proposal that would have Congress develop and approve a compact based on an origin sourcing regime for remote sales coupled with administrative and redistribution provisions adopted from the International Fuel Tax Agreement (“IFTA”). This proposal suffers from all of the problems of an origin system and inherent in IFTA with the additional problems created by merging the two and limiting the rules to remote sellers.

In particular the proposal would, quite surprisingly, decouple the choice of how to tax a transaction from the jurisdiction receiving the benefit of the tax. It is the equivalent of letting France unilaterally decide whether the US will get tax revenue from a phone call between a woman in Ohio and her friend in Paris.

The proposal not only fails to fix the jurisdictional uncertainties currently faced by remote sellers, it aggravates them. This origin system would apply only in states where a particular remote seller does not have physical presence under *Quill*. As we know, it is frequently not clear whether a vendor has the requisite physical presence in a state. If a seller has physical presence, the proposal would leave the existing destination based tax calculation and remittance system in place. If the seller does not have the requisite physical presence, the origin state’s rules will apply. As such, remote sellers operating in the all too frequent nexus gray area would be at risk that they collected an origin tax when they were obligated to collect the destination state’s tax rate and apply the destination state’s rules.

Furthermore, consumers will be confused because they will be subject to different tax rates based not only on where the vendor is located but also on whether the vendor is physically present in the state in which the consumer is located. Asking consumers to pay tax based on the proposed basis is no less absurd than asking them facts that are not under their control or understood to them is tantamount to asking them to pay tax

For remote sellers and their consumers, this proposal fundamentally changes the economic effect of the traditional state sales tax because the proposal converts a consumption tax regime into a production tax regime.

Finally, the proposal suffers from serious constitutional problems and would be inconsistent with the protections Congress afforded sellers in the Internet Tax Freedom Act, which prohibits states from imposing discriminatory tax rates on Internet-based commerce.³³

C. Option 3: Require Reporting, Not Collection

If a national reporting regime for purchases is enacted, either remote sellers will acquiesce and collect tax to avoid the reporting burden or consumers will shoulder the burden of tax compliance. A national reporting regime would be more burdensome than today's sales tax collection obligation. While there are various alternative reporting regime concepts being discussed, each of them would cause significant problems. Whether the proposal considered utilizes a Colorado-type approach where vendors turn over data about consumers directly to the government or an approach where the vendor and software companies work to turn over data to the government, each approach shares fundamental problems.

Any reporting regime would create significant privacy concerns as remote sellers would be required to provide detailed information about each of their consumers and their purchases to allow states to enforce use tax. Whether this information is maintained in a national database or by individual states, the threat to privacy is clear.

To defend the proposal by arguing that it would not be necessary to capture and maintain information about specific purchases undermines the workability of the proposal. Without that information, it will be impossible for consumers to comply with their use tax obligation or for states to enforce it. Under a reporting regime, if a state audited a consumer for use tax compliance, the state and the consumer would have to know what items were purchased by the consumer (and the dollars spent), whether those items were taxable, and whether the vendor had

³³ 47 U.S.C. § 151.note.

charged tax. In current audits, because the audit is of a seller, the identity of purchasers is not typically needed to audit the seller's taxability determination. The only information needed is whether the seller appropriately treated the product as taxable or not. The reporting regime approach thus threatens to expose personal consumer purchasing information in an unprecedented manner.

Concerns over the capture, transmittal, and maintenance of data regarding consumer purchases speak against the regime as a solution to the Internet sales tax issue. Whether the reporting captures individual items purchased by consumers, or vendor names that are selling to consumers, the potential for harm is clear. Again, it is important to note that without capturing that sensitive information, the regime would not work to allow use tax enforcement.

A version of the reporting regime proposal indicates that it would not be necessary to capture detailed information about consumer purchases. Instead, the proposal would require new software be developed to interface between vendors and the government to sanitize data such that the government did not receive detailed information.³⁴ It is unclear why sellers or the states would fund the software and integration costs for a system that did not result in tax being collected. It is also unclear how such an expense is justified under a system that still leaves tax compliance incomplete while threatening disclosure of consumer purchase information.

Rather than face the consumer privacy concerns and costs of a new reporting regime, some sellers are likely to choose to collect tax, doing so without any of the protections, uniformity and technology that would be addressed by a compact or framework that sets rules for sales tax administration.

Although consumers today have liability for use tax, states have not widely enforced the obligation because of auditing inefficiencies and/or political concerns; the reporting regime approach would unequivocally place the tax compliance burden on consumers. Should the proposal require sellers to report only gross sales, the taxability determination would be left up to

³⁴ <http://www.floridasalestax.com/Florida-Tax-Law-Blog/2014/March/US-SALES-AND-USE-TAX-SYSTEM-NEEDS-FEDERAL-C-P-R-.aspx> (last visited March 7, 2014).

the consumer. For exempt purchases, consumers would have the burden of documenting and proving that they were not subject to tax. Even if the states were to offer a theoretically standard exemption,³⁵ a consumer wanting to claim actual exempt purchases would have the burden to prove the exempt amount. This approach would burden all consumers and would significantly disadvantage the unsophisticated consumer. For instance, if a consumer makes significant purchases of exempt items such as clothing or food (frequently exempt in states), then that consumer would have to take the following steps: receive the report of their gross purchases, calculate the standard exemption, calculate her actual exempt purchases based on individual receipts and knowledge of the state's tax law, compare the two exemption amounts, file a return remitting use tax based on the greater of the two exemption amounts, and maintain all receipts and documentation to prove the exemption claimed for a potential future audit.

While the reporting regime approach would lead to audits of consumers, such enforcement of consumer liability would be inconsistent at best. Limited state resources would inevitably prevent states from effectively enforcing the law against all consumers. An additional consideration is that while some states require consumers to pay use tax in conjunction with their income tax filing obligation, not all consumers are required to file income tax returns.³⁶ These consumers would be forced instead to file a use tax return to report their liability or risk the threat of audit, interest and penalties. Budgeting and paying use tax annually may also be difficult for certain taxpayers that have historically relied on our federal and state tax withholding systems to ensure their compliance with the law. The approach erodes government efficiency by forcing states to audit individuals rather than making the seller responsible for tax collection.

D. Option 4: Grant States the Power to Exclude Instead of the Power to Tax

Congress' role should be to facilitate interstate commerce and ease the burden of tax collection on interstate sales, not to set up barriers to commerce and therefore impose harm on

³⁵ *Id.*

³⁶ A taxpayer could be not required to file an income tax return because his or her state does not have an income tax or because the taxpayer's taxable income does not exceed a certain threshold.

our country's economy. Even if such an approach were adopted there are serious questions about how it would be enforced. Would states be authorized to stop deliveries by common carriers and the U.S. Post Office? Buyers would be confused by their inability to buy from a company located outside their state. And for vendors who decided to collect tax, rather than suffer the prohibition on making sales, there would be no simplification, uniformity, protections or software tools made available to facilitate the effort. The harm to interstate commerce would be much more dramatic than a simple requirement to collect tax.

E. Option 5: Origin-based Collection

An origin-based collection regime would constitute a complete overhaul of the nation's existing sales tax system. This approach is so dramatic that it would likely result in the elimination of sales tax as a funding option for states. States that did not eliminate their sales tax would lose their business base as remote sellers set up operations in states without a sales tax. The threat of such economic disruption would likely convince most, if not all states to eliminate their sales taxes. No other country in the world uses origin sourcing for consumption tax purposes. I would also note that U.S. companies would be forced to collect sales tax on sales made to customers outside the U.S. and imports would be exempt from sales tax under such a proposal – obviously creating competitive problems for U.S. based businesses and an incentive for businesses to move off-shore.

VI. Conclusion

Congressional action creating a framework for remote sellers to collect sales tax is required to truly solve the Internet sales tax issue. In the absence of Congressional involvement, states have shown they will certainly try to solve the issue on their own; because their authority regarding interstate commerce is limited, their approaches will create even more problems for Internet vendors and consumers. Should Congress choose to squarely address the Internet sales tax issue, its framework should be built around existing state tax policy decisions and should not radically upend the sales tax regime as others would propose.

Testimony of Stephen P. Kranz
United States House of Representatives
Committee on the Judiciary
March 12, 2014

Mr. Chairman, I again thank you for the opportunity to speak before this Committee today. I welcome questions from you and the Committee.

Testimony of Stephen P. Kranz
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Appendix

**Additional Analysis of
Option 2: Compact to Collect & Redistribute Sales Tax**

- A hybrid approach that combines the redistribution and some of the administrative concepts of the International Fuel Tax Agreement (“IFTA”) with origin based imposition and collection, and applies such a system solely to remote sales, is an approach with serious infirmities.
 - Even though IFTA contains admirable concepts (*e.g.*, a single return, redistribution and credits, a home state for registration), it still contains compliance and efficiency challenges.
 - IFTA requires customers, i.e. the truckers and trucking companies, to self-assess each state’s tax based on the consumption that occurs in that state. A credit is given for any taxes paid to a vendor.
 - Thus, IFTA’s concepts are not scalable from the limited-vendor, single-product environment of fuel sales where returns are filed by customers to the extensive economy of all types of remote sales and sellers where returns are not filed by customers but by the sellers.
 - Collecting tax based on the state of origin’s laws creates harmful economic distortions by incentivizing businesses to make geographical decisions based solely on taxes.
 - Combining IFTA and origin-based collection only creates additional problems not intrinsic to each system on a stand-alone basis.
- The proposal would still have most of the problems associated with an origin based system, including the following that deserve particular note:
 - Under the proposed approach, taxability and tax rate would be determined based on where a seller’s “home state” is located. When the seller’s home state does not impose sales tax, the seller would charge no tax on the transaction even if one of the following is true: (1) the product was delivered to a purchaser in a state that would tax the purchase or (2) the purchased product would be used in a state that would tax use of the product.
 - Sellers in a state with a sales tax could decrease the total cost of their products to all consumers merely by relocating the location of their “home state.” The proposed hybrid approach would allow remote sellers to easily manipulate their business model to ensure that the home state is a state without a sales tax.
 - If home state is based on state of incorporation, then retailers will just reincorporate in a state with no sales tax.
 - If home state is based on where products are shipped from, then retailers will locate or use warehouses in a state with no sales tax.
 - Companies could easily manipulate the home state by simply creating a separate entity in a home state that has no sales tax, to operate as the seller of record while other operations are carried on outside that state.

- The economic incentive on sellers to relocate to states without a sales tax would in reality force states to eliminate their sales taxes altogether, or accept harm to their economic climate and competitive disadvantage for in-state businesses.
- Coupling an origin collection rule with an IFTA redistribution arrangement adds additional problems to already undesirable options.
 - The proposal bifurcates the jurisdiction deciding whether and how to impose the tax from the jurisdiction that receives the financial benefits of the tax. Why would any jurisdiction that does not receive the benefit decide to impose a tax?
 - Under the hybrid approach, not only the tax rate, but also taxability is determined by the home state's laws. This strange approach would lead to confusion for consumers. Instead of consumers being subject solely to the laws of their own jurisdiction, they would be subject to the laws of every jurisdiction from which their purchases originate. For example, consumers used to buying clothing or food items tax free, because their state of residence allows an exemption for such goods, would lose this exemption when purchasing from a remote seller located in a state that taxes such goods.
 - The proposal is not consistent with sound economic theories because it imposes a tax based on production but distributes the benefits of the tax based on consumption.
 - The hybrid approach does not follow the policies supporting IFTA. IFTA is based on a theory that tax should be paid to the state where a product is consumed, which is why the tax is structured as an imposition on the customers who have knowledge of the consumption and not the vendors.
 - The hybrid approach only applies to remote sales, *i.e.*, sales made into a state by a seller without physical presence in that state. It thus perpetuates the jurisdictional issues of the current system caused by the physical presence rule and piles on confusion for the consumer.
 - Based on experience with the current system, it is frequently unclear whether a vendor has the requisite physical presence in a state. If a seller has physical presence, the proposal would leave the existing destination based tax calculation and remittance system in place. If the seller does not have the requisite physical presence, the origin state's rules will apply. As such, remote sellers operating in the all too frequent nexus grey area would be at risk that they collected an origin tax when they were obligated to collect the destination state's tax rate and apply the destination state's tax rules.
 - This approach will create confusion for consumers as some sellers will collect on a destination basis – if they have physical presence in the destination state; and some sellers will collect on an origin basis. Consumers will not know what tax will be collected on any given purchase until they checkout. Consumers will have no way to know

- whether the purchase is subject to tax in the origin jurisdiction, or whether the tax rate being charged is correct.
- The hybrid approach will further complicate consumer use tax compliance.
 - While the approach provides that the seller will collect tax on the transaction, it appears that sellers would not be collecting the tax that is owed by the consumer and consumers would remain liable for any use tax differential. If the home state applies a tax rate that is lower than the rate imposed by the destination state, or the product is exempt in the home state, the consumer will continue to owe use tax on the transaction. Calculating the remaining use tax differential will be a tremendous burden on consumers.
 - The hybrid approach will cause a tax increase for consumers.
 - Consumers would be liable for the greater of the tax charged on an origin basis or the use tax applicable in their state of residence. As a result, the consumers would face an increase in tax liability compared to their use tax exposure under the current system.

Additional Analysis of Option 3: Require Reporting, Not Collection

- A federally-mandated use tax reporting regime, such as the one adopted by Colorado, would: force remote sellers to collect sales tax without the protections of a Congressional sales tax collection framework; raise privacy questions; fail to prevent state anti-*Quill* legislation; require a massive new federal infrastructure; and impose a tremendous burden not only on consumers but also on all vendors.
- At least one version of the reporting regime proposals has preliminarily suggested the following elements:³⁷
 - Remote sellers would be required to report sales information to a federal database, either directly or through software vendors.
 - The remote sellers and software vendors would determine the taxability of categories of products.
 - Alternatively, remote sellers and software vendors would provide gross sales, and each state would set a standard exemption for consumers to use based on the state's exemption laws. Consumers could file a return claiming a larger exemption and support it on audit.
 - The database would generate 1099-style reports that aggregate all remote sales information for a consumer. Information would be aggregated based on federal tax ID number, credit card number, and a new optional US sales tax identification number. It is not clear whether each vendor would generate a separate 1099-style report or whether all vendors would somehow be aggregated.
 - The information would be sent to the consumer and to the state.
 - If a consumer does not file a use tax return, states could send audit letters to those taxpayers.
 - Consumers could access their purchasing history, and provide that data only when needed to prove an exempt sale.
 - The federal government would set up standard information reporting for software vendors. The software vendors would be funded by the states, based on the volume of sales processed through the reporting system.
 - States would be able to audit software vendors and remote sellers to determine the accuracy of their taxability decisions.
 - Remote sellers with nexus would be required to collect tax; if a remote seller follows the reporting requirements while under the mistaken belief that it does not have nexus, once the mistake is discovered, the seller would only have a prospective obligation to collect tax and could not be held liable for tax on past sales.
 - *Quill* would be codified in statute.

³⁷ <http://www.floridasalestax.com/Florida-Tax-Law-Blog/2014/March/US-SALES-AND-USE-TAX-SYSTEM-NEEDS-FEDERAL-C-P-R-.aspx> (Last visited March 7, 2014).

- There could potentially be a small seller exception.
- This reporting regime proposal is problematic for many reasons:
 - Whatever the intention behind the proposal, it would likely result in remote sellers being forced to collect sales tax without the protections of a Congressional sales tax collection framework. Remote sellers would be faced with a choice: either provide annual (and probably per-transaction) notices to consumers informing them of use tax obligations, or collect tax from those consumers at the time of sale.
 - Consumers would be faced with a choice: either find a retailer that will collect sales tax at the time of purchase, or be forced to file use tax returns at the end of the year and be subject to audit.
 - To implement this reporting regime would require a massive new federal infrastructure.
 - To implement this reporting regime would require businesses to invest in new software and systems to track the necessary data. To the extent that states are required to fund the software, the proposal would raise unfunded mandate concerns.
 - To implement this reporting regime would require states to build out a sophisticated and expensive use tax enforcement program. To the extent that states are required to participate, such a requirement would raise unfunded mandate concerns.
 - The reporting regime proposal makes no allowance for exempt sales for resale; failing to exclude the resale transaction data from the database or reporting provision makes the data largely unusable and dramatically increases the likelihood that businesses buying for resale will be subjected to audit scrutiny unnecessarily.
 - The prospective-only correction mechanism included in the proposal is an invitation to game the system.
 - For consumers who buy from remote sellers operating under the reporting regime, this proposal has serious privacy implications. Although the proposal makes an attempt to sanitize information given to the states and federal government, it leads to a clear threat that consumer purchasing information will be disclosed to the government. Even if information on a product is sanitized, there could still be privacy issues that arise from identifying which vendors are making sales to a particular consumer.
 - The proposal would either require that consumer purchases be reported to the government or would require that they be disclosed on audit as states sought to enforce their use tax. Without information about individual purchases, the proposed regime would not be helpful to use tax enforcement.
 - Under current audits, states do not need, nor do they obtain, information on purchases by individual consumers. A vendor indicates whether it collected tax or not on sales of an item, and the state then determines if that taxability decision

- is correct. A state typically has no need to determine what items were bought by an individual, just if tax was collected on those items by the vendor.
- The proposal increases the potential for identity theft by gathering tax ID information along with credit card information for every remote transaction. While the details of the proposal are not complete one can hardly imagine that mandating the accumulation of data in this manner would not make it susceptible to identity theft.
 - Even if a reporting regime is in place, states will continue to push for an overturn of *Quill* or push for remote sellers to be deemed to have a physical presence in the state so that the remote sellers remit the tax and can be audited. Such an arrangement is much more palatable politically and economically for a state than enforcing a use tax obligation against its citizens.
 - State enforcement of the use tax through a reporting regime approach would shift the full burden of tax compliance to consumers. In addition, the regime would create a new reporting burden on vendors.

**Additional Analysis of
Option 5: Origin-Based Collection**

- Origin sourcing for a consumption tax is a quintessential example of taxation without representation. Under an origin regime, a purchaser pays tax to the jurisdiction of the seller – a jurisdiction with which the purchaser has no connection or representation. Purchasers would be paying to fund services that they would never receive and would lack the ability to affect that jurisdiction’s tax legislation through elected representatives.
- As Professor Walter Hellerstein notes in his treatise, consumption taxes using destination sourcing promote neutrality by treating all goods consumed in a state in the same way, regardless of the shipment origination location. Hellerstein, *State Taxation*, ¶18.02[1].
- Origin sourcing is the nuclear bomb version of tax competition – it will in practice eliminate the sales tax as a source of state revenue. If origin sourcing is implemented, purchasers will have the immediate option of buying tax free from sellers in no-tax states. To compete, businesses located in states that impose a sales tax will demand that their states eliminate sales taxes, or the sellers will relocate to a state with no sales tax, or to another country. States will be forced to eliminate sales and use tax as a vehicle for government funding to “compete” with the states that have designed their tax system without a sales tax.
- No country in the world that imposes tax on consumption uses an origin sourcing approach, in part because origin sourcing gives a clear tax preference to imports from foreign sellers. These sellers will not have to collect sales tax, and, as noted, domestic companies will be forced to relocate to compete. U.S. companies will still have to collect tax on sales made to foreign jurisdictions, which all use destination sourcing.
- Origin sourcing is tantamount to a federal mandate to eliminate sales and use tax, impinging on important sovereign state tax policy choices. Every state and locality has made very specific decisions on how to fund government services, using many different tax and fee options. State and local governments would no longer be able to choose to tax consumption. Congress will have stripped them of that possibility by making it economically disastrous to do so. Further, to offset for lost revenue, states will increase other taxes imposed on their residents, such as property taxes and personal income taxes.
- Origin sourcing would result in chaos and confusion for purchasers. Instead of a purchaser paying one tax rate based on where he or she lives, the purchaser would pay tax based on the rate applicable in the shipped-from location, over which the purchaser has no control and no understanding.
- Origin sourcing will either violate the Due Process Clause or will require a massive restructuring of the existing sales and use tax system. If Congress only requires that

states use origin sourcing without mandating a fundamental change in state sales and use tax imposition, this will result in the vast majority of states sales and use tax statutes being in violation of the minimum contacts requirement of the Due Process Clause. *See Daimler AG v. Bauman*, 571 U.S. ____ (2014); *International Shoe Co. v. Washington*, 326 U.S. 310 (1945). Most states place the legal incidence of the sales tax on the purchaser; the seller is only required to collect the tax from the purchaser and remit it to the state. Mandated origin sourcing, without changing the legal incidence of the tax from the purchaser to the seller, would violate the Due Process Clause because in most cases the purchaser would not have the necessary connection with the state of origin for that state to exert its taxing jurisdiction over the purchaser. The purchaser would merely be ordering something with no knowledge or interest in what state the product would originate – and thus be taxed. The only other option is, in the wake of a Congressional origin sourcing mandate, for every state to change its use tax statute imposed on the purchaser to a sales tax statute imposing the tax on the seller. This not only raises significant logistical legislative challenges, but also raises issues regarding to what extent could a seller specifically pass-through the tax to a purchaser. Thus, absent a mandate that states legislatively alter the party on which the tax is legally imposed, a congressionally mandated origin sourcing regime would be constitutionally infirm.

**Additional Discussion:
Due Process Issues**

- Any legislation, regardless of its subject matter, is subject to Due Process protections. There is nothing about legislation overturning *Quill* that raises unique Due Process problems.
 - *Quill Corporation v. North Dakota*, 504 U.S. 298, 305 (1992).
- As Professor Walter Hellerstein noted in his treatise, “Congress possesses unquestioned power under the Commerce Clause to regulate state taxation of interstate commerce.” Hellerstein, *State Taxation*, ¶4.24. The U.S. Supreme Court invited Congress to act on this issue, and noted that while Congress had full power to regulate interstate commerce, Due Process protections would remain, regardless of Congressional action. *Quill Corporation v. North Dakota*, 504 U.S. 298 (1992). Congress has the ability to establish the framework necessary to ensure remote sellers are able to collect all state’s sales and use taxes, while minimizing any undue tax burdens of complying with such system based upon the simplifications and protections set forth in the federal legislation.
- The Due Process Clause requires a person to purposefully avail themselves of a forum state before being subject to personal jurisdiction (or taxes) in the state. *International Shoe Co. v. Washington*, 326 U.S. 310 (1945). The Third Circuit has held that “mere operation of a commercially available web site” does not show that an operator purposefully availed itself of a forum state. *Toys "R" Us, Inc. v. Step Two, SA*, 318 F. 3d 446, 454 (2003). **However**, in the same case the Third Circuit held that “[i]f a defendant web site operator . . . knowingly conducts business with forum state residents via the site, then the “purposeful availment” requirement is satisfied.” *Toys "R" Us, Inc.*, 318 F. 3d at 452.
 - If a remote seller is operating a website accessible in a state and transacting business with a purchaser, then the remote seller has likely purposefully availed themselves of the jurisdiction.
- A congressional grant under the Commerce Clause of jurisdictional authority to states is not a new concept and has been successfully implemented in the past – with few due process problems.
 - McCarran-Ferguson Act – removes Commerce Clause restrictions on interstate regulation of insurance, including state taxation of insurance companies.
 - Mobile Telecommunications Sourcing Act – establishes the jurisdiction able to tax cellphone usage and related services.
- When it comes to Congressional regulation of state taxes, a Due Process violation could occur only if a state improperly exercised the authority allowed by Congress. The risk of state Due Process violations exists today and is not exacerbated or enhanced by Congressional action.

- The PACT Act is not analogous to the existing proposals for Congress to overturn *Quill*'s Commerce Clause limitations. Unlike proposals to overturn *Quill*, the PACT Act placed an affirmative burden on businesses by requiring them to comply with state and local tobacco tax laws on remote sales as if the sales occurred in a state. 15 U.S.C. § 376a. The PACT Act created a jurisdictional fiction; this jurisdictional fiction is what created the Due Process problems and that fiction does not exist in the efforts to have Congress overturn *Quill*.
 - Furthermore, the PACT Act litigation arose in a different context than the hypotheticals used against legislation to overturn *Quill*. The PACT Act litigation involved businesses seeking to enjoin the federal statute from deeming a sale to have occurred in a state regardless of the actual contacts with the state. I am unaware of any examples where a state has sought to justify enforcement of its tobacco tax laws on a remote seller in violation of Due Process by invoking the PACT Act.

**Additional Discussion:
One Rate Per State for Remote Sales**

- A one-tax-rate-per-state requirement would force at least half of all local governments to raise their tax rates. In states that allow localities to impose local sales tax, each locality chooses the tax rate applicable to consumers in that jurisdiction. Requiring localities to all adopt the same tax rate (the implicit mandate of a one rate tax system) would force localities with a lower tax rate to raise their rate such that all localities had the same tax rate, leading to a rate that equaled the “highest common denominator.”
- Tax rates applicable to consumers who live in a city, county or other jurisdiction should not be determined by federal legislation. Local political processes are in place to establish tax rates applicable to constituents who live in those jurisdictions. It is those constituents who rely on government services and who should have a say in the rate applicable to their purchases. Congressional interference with state and local tax rates would impinge on the political sovereignty of state and local governments in a way that disrupts decision-making for important local programs.
- A one-tax-rate-per-state requirement would impose a new burden on purchasers to track the difference between the rate collected by a remote vendor and the actual combined state and local rate applicable to the transaction. If the actual combined state and local tax rate exceeds the rate collected by a remote vendor, the purchasers would have an obligation to pay the difference as a use tax liability on their purchase – unless Congress also mandated the elimination of use tax as it is known today. The additional tax obligation would require purchasers to track whether their vendors were collecting the actual state and local tax rate or were collecting under the one rate regime. Purchases made from remote sellers operating under the one rate regime would be subject to additional use tax exposure analysis. Purchases made from sellers that had pre-existing nexus would be taxed at the actual state and local rates. Consumers would have to track each purchase to determine which method was used and whether additional use tax was owed.
- Imposing two different tax rate rules on a vendor based on whether that vendor had nexus in the destination jurisdiction would be more administratively burdensome than today’s tax regime – it would require vendors to maintain two types of tax collection, reporting, and remittance.