Summary
This memo will consider the relationship between electronic commerce and state fiscal policy, through analyzing the e-commerce and tax policy background, as well as the current situation of interstate Internet sales. It would be paid a particular attention to reinforcement of the tax collection system from online sales without violating any constitutional and Supreme Court mandates, and taking into consideration the tax policy principles of efficiency, fairness, cost-effectiveness, compliance and accountability.
In order to do so, the first recommendation consists of adopting the tax policy harmonization and simplification, among state jurisdictions, which should include at least definition of common tax base, rate and exemptions. The second recommendation, which could be implemented simultaneously with the first one, is oriented to provide private firms that lead the electronic commerce in the U.S. with correct incentives, which could transform them into strategic allies of the state governments on collecting on-line sales taxes, without waiting for passing of required federal neither state legislation.

E-commerce and tax policy background
Only fifteen years ago, the electronic commerce appeared to have had little impact on fiscal policy. Now this relationship is perfectly bidirectional, since both fiscal policy and e-commerce have a huge impact on each other. The total tax-losing online sales in 1999 were just under $9.7 billion that represented 4.7 percent of the total sales tax revenue of $203 billion (U.S. GAO, 2000). With an average sales tax rate across states of 6.33 percent, the implied loss of tax revenue in 1999 was only $612 million (Goolsbee, 2001), which could be considered as a not too alarming figure. However, at the rapid pace online sales have been expanding, the problem has become increasingly worrying.
In 2010, U.S. Internet retail sales topped $176 billion and are expected to reach $279 billion by 2015, according to Forrester Research Inc. Online sales currently account for about 9% of total retail sales, a share that's projected to triple over the next few decades, reason that has made the rise of Internet commerce a plum target for wider taxation. Hence, the online sales would cost states up to $23 billion in tax revenue in 2012 (National Conference of State Legislatures, 2011). Since sales taxes account for about 20 percent of state revenues according to International Council of Shopping Centers, it is easy to understand the fear politicians have of e-commerce. This why in the past few years, a debate over taxes and the Internet has raged at the highest levels.
However, a challenge for both federal and state legislator is not minor. In addition to a mix of political and corporate issues pertained to the taxation of the e-commerce, as explained below, a new fiscal strategy should respond to the traditional principles of sound tax policy.
According to Brunori (2011), a “good” tax policy is based on the following five principals: (i) raising adequate revenue; (ii) neutrality or efficiency; (iii) fairness; (iv) ease of administration or cost-effectiveness and compliance; as well as (v) accountability. Most if not all of these principles should be taken into consideration in order to balance the final tax policy on e-commerce.
On one hand, the online sales should be taxed in neutral and fair manner, which implies that the taxes should have as little effect on market decisions as possible, minimizing at the same time, potential market distortions and efficiency losses. Moreover, a tax system should treat similarly
situated taxpayers the same (horizontal equity); while the taxpayers should also bear a burden of paying for government services based on their ability to pay (vertical equity). On other hand, a sound tax policy should allow minimizing the cost of compliance for taxpayers and of collection for the governments; while, from accountability perspective, the governments should ensure that the tax administration and collection enforcement are carried out in efficient and transparent fashion. In other words, more complicated taxes imply higher administrative and compliance costs for both taxpayers and governments, situation that also increases the risk of tax evasion and governmental corruption and inefficiency.

**Current situation**
According to Goolsbee (2001), the traditional burden of collection for sales taxes resides with merchants. When a customer buys something at the bookstore, the merchant collects and pays the sales tax to the state. However, based on the Constitution, which prevents states from taxing “interstate commerce”, no state can force an out-of-state merchant to collect or pay sales/use tax unless it has a “nexus” in the state.

Thus, the applicable legal principles regarding e-commerce taxation were inherited from mail-order taxation. The Supreme Court has ruled in 1967 that a state has no jurisdiction to require an out-of-state merchant with no employees or other physical presence in a state, known as "nexus", to collect the tax. This pronouncement was reaffirmed in 1992 in the famous Quill Corp. (a big catalogue seller) v. North Dakota case, since according to the Supreme Court it was too burdensome for the out-of-state seller to discover what tax the customer should pay.

In other words, when Seattle-based Amazon, a company whose stock market valuation is nearly $100 billion with net sales in 2010 of $34.2 billion (Amazon.com Annual Report 2010), sells a book to someone in California, the state cannot require the out-of-state retailer to add California sales tax to the purchase. In places where the merchant does have nexus, the state can make such a requirement.

It should be noted that sales taxes for any state are legally due on Internet and mail-ordered purchases that would be taxable if the items were bought in a local store. If the retailer does not collect the taxes, the buyer is supposed to remit them to the state. Nevertheless as a practical matter, unless the taxes are collected by retailers, they are virtually never paid. As online shoppers well know, some Internet retailers collect sales tax and some do not. What many people fail to realize, however, is that the tax is still due. Residents are supposed to self-report what they owe in their annual state income tax filing, but most people do not.

In addition to state sales tax losses, this situation implies that thousands of businesses are forced to do business at a competitive disadvantage because they have to collect taxes and online sellers do not, which in some states can mean a 5 to 10% price advantage. This current state of affairs represents threats to efficiency principles of tax policy, which are further discussed in this memo with an example of the state of California.

In order to offset a sales tax-losing impact, some states have introduced a “use tax” of the same rate for those goods bought out of state where sales tax aren't collected by the merchant. Hence, the use tax is levied on the consumer. However, the collection enforcement of this tax is also extremely complex and expensive, with exception of some goods that must be registered (like automobiles), as well as for taxable business purchases (such as computers), since larger companies are systematically audited for use tax compliance.

Some other states facing a revenue loss have initially reacted by establishing taxes on internet access, which unfortunately could significantly delay the spread of broadband and adoption of new technology in a number of smaller-sized markets, leading to dynamic losses much greater than conventional losses associated with the revenue generated by the tax (Goolsbee, 2001). This policy led to the enactment of the 1998 Internet Tax Freedom Act, a law that prevents federal,
state and local governments from taxing Internet access and interdicts other types of taxes over the Internet. These additional measures were not sufficient, however, to make taxation of online sales more efficient, transparent and cost-effective. Instead, economic distortion created from diverting commerce from retail stores to on-line venues for the purpose of avoiding taxes, high compliance costs and low collection rates continued to be a concern for both legislators and public administration officials.

The dilemma
Is it feasible to reinforce the tax collection from online sales without violating any constitutional and Supreme Court mandates, but taking into consideration the principles of efficiency, fairness, cost-effectiveness, compliance and accountability?
According to Goolsbee (2001), partially due to historical circumstance, most people in the United States are not paying sales taxes on their purchases over the Internet. As a result, many state and local officials have become quite agitated that the rise of the Internet is severely eroding the state and local tax base.
Currently, several states are seeking to get around the restrictions imposed by Supreme Court, related to taxation of out-of-state merchants with no employees or other physical presence in a state, by passing laws that expand the definition of physical presence. Until now the target has been on those e-commerce sites, such as Amazon.com and other Internet-based retailers, which make wide use of in-state affiliates to promote sales. These are generally local businesses and nonprofit organizations that place links on their web sites to the retailers’ sites and receive a commission when someone clicks through.
The state of California, for instance, thought it has found gold in taxing e-commerce. But that money is proving much more elusive than it seemed just a few months ago. At the beginning of the summer of 2010, the state passed a law requiring online retailers with a physical presence in the state to collect sales taxes. However, this struggle is proving divisive. Immediately after the law was passed, Amazon, that has a long history of fighting requirements for shoppers to pay their local state sales tax whenever a purchase is made via the Internet, cut off its California affiliates. According to The Street (2011), these were more than 10,000 of web sites that referred customers to the retailer’s site in return for a cut of the transaction. If they constituted a physical presence under the law, Amazon wanted to be rid of them.
The case of state of California could be a good example to analyze the background and effects of a new tax policy. On one hand, the rationale to impulse new tax legislation is clearly originated by the need of strengthening the principles of “raising adequate revenue” and “compliance”. At the same time, that agreement was a victory for traditional retailers, who say they've lost billions in sales to Internet merchants that sell identical merchandise free of sales taxes. Thus, the new legislation could be also explained by existence of external interests, such as pressure and lobbying of conventional retail corporations, like Wal-Mart Stores Inc., Target Corp., and other major chains and small local book-stores, to push legislators to close legal loopholes that allow online sellers to dodge sales-tax collection in most U.S. states.
In response, Amazon decided to fight, due to fears that a defeat in California will sway legislators across the country, and that it will lose a critical pricing advantage over the bricks-and-mortar stores.
A new law has also contributed to loosing of additional income by thousands of local businesses and nonprofit organizations, creating economic distortion that pushed those small businesses to move their physical presence to other states, such as Nevada that has a border with California. These two phenomena exposed that the efficiency principle is still need to be enforced.
Although the state of California has finally reached an agreement with Amazon, which consisted
of delay of the passage of a new law until September 2012 in exchange for Amazon’s announcement on starting tax collection from their customers by January 2013, the nationwide compliance and accountability costs still remain relatively high, since tax collection enforcement continue to be an issue for interstate commerce, especially for online sales that do not require strong physical presence in the state.

**Recommendations**

According to Garcia Bañuelos (2011), while the indirect taxation of traded physical goods across borders is complicated, the taxation of online sales or electronically downloadable products is even more problematic. In the case of the U.S., tax competition on sales tax does not pose such a threat, since interstate electronic commerce is, in practice, exempt.

In order to reinforce the tax collection from online sales without violating any constitutional or Supreme Court mandates, taking into consideration, at the same time, the principles of efficiency, fairness, compliance and accountability, two main recommendations could be done. The first one consists of harmonization and simplification of tax policy among state jurisdictions, which at least should include definition of common tax base, rate and exemptions, if any. In fact, this proposal is not new. However, for the past 20 years, states have been unable to enforce their own sales and use tax laws on sales by out-of-state, catalog and online sellers due to the 1992 Supreme Court decision. Moreover, the Congress has been also debating solutions for more than a decade, but some states have been forced to take action on their own, such as creation of the Streamlined Sales Tax Project (SSTP) in the year 2000.

Since this is a matter of interstate commerce, the Congress should grant the authority needed for states enforce sales tax collection and remittance from out-of-state sellers. Some of the most recent bills associated with this recommendation are “Marketplace Fairness Act”, “Main Street Fairness Act” and Marketplace Equity Act.

In summary, these bills grant states the authority to compel online and catalog retailers, no matter where they are located, to collect sales tax at the time of a transaction - exactly like local retailers are already required to do. However, in order to do so, the states are required to simplify their sales tax laws to make multistate sales tax collection more efficient and easier (Marketplace Fairness Act Information, 2012). This could be done by joining the twenty-four states that have already voluntarily adopted the simplification measures of the Streamlined Sales and Use Tax Agreement (SSUTA).

The second recommendation, which could be implemented simultaneously with the process of tax policy harmonization and simplification, is oriented to give those private firms that currently lead the electronic commerce in the U.S., such as Amazon, correct incentives to start immediately collecting the on-line sales taxes on behalf of the state governments, without waiting for the passing of required either federal or state legislation.

As mentioned before, Amazon for years has fought state efforts to force it to collect sales taxes from its customers. However, this situation could be inverted if the state governments prove Amazon and other major Internet sellers that collecting taxes from on-line sales could be mutually beneficial, since collecting taxes could also represent a business opportunity through charging a reasonable fee to hundreds of thousands affiliated small businesses in exchange for handling their sales-tax responsibilities. The implementation of this win-win strategy could bring millions of dollars in state tax revenue, but also providing extra revenue for Amazon and others.

Hence, with this proposal, instead of battling the tax man, the online companies could be turned into fierce defenders and actual collectors of the Internet sale tax. And while there are still too many differences from state to state in tax regulations for any kind of federal supervision to be practical, this recommendation could finally solve the interstate online sale tax collection dispute in an efficient and even profitable way.
Annex 1: States members of the Streamlined Sales and Use Tax Agreement (SSUTA)

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Notes:
✓ A Full Member State (FM) is a state that is in compliance with the SSUTA through its laws, rules, regulations, and policies.
✓ An Associate Member State (AM) is a state that is in compliance with the SSUTA except that its laws, rules regulations and policies to bring the state into compliance are not in effect but are scheduled to take effect no later than 12 months after becoming an associate member.
✓ Five states have no sales tax (NS): Delaware, Montana, Oregon, New Hampshire and Alaska.

Source: http://marketplacefairness.org/compliance/
Bibliography