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Understanding an Internet Sales Tax

A Primer on Leading Proposals and the Political State of Play

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The rapid growth of online retailing has been accompanied by calls from state and local officials for greater authority to capture more sales tax revenue, as well as from brick-and-mortar retailers to allow states to “level the playing field” by collecting sales tax from anyone who sells to their residents, regardless of the seller’s location. Currently, under the Supreme Court decision, *Quill v. North Dakota*, a seller must have a physical presence, or “nexus,” in the buyer’s state to become subject to the latter state’s sales tax. Far from a tax loophole, this is the principle of “No taxation without representation” in action. The seller, not the buyer, calculates and remits sales tax. While this arrangement can lead to different sales tax treatment among different types of retailers, it greatly benefits consumers by preserving healthy tax competition among states.

Policy Recommendation. Attempts to expand states’ abilities to tax online sales across borders are wildly unpopular with voters and fly in the face of fiscal conservative principles. By contrast, an origin-based sales tax approach would address the inequities of the current regime without any of the negative consequences of allowing states to tax non-residents. It also presents an opportunity for conservatives to reach out to young, Internet-savvy voters.

Leading Proposals

The Marketplace Fairness Act (MFA) passed the Senate in 2013 and was reintroduced in the current Congress, but companion legislation has stalled in the House. The MFA empowers states to reach across their borders and collect sales tax from companies based in other states. It would impose high compliance costs on businesses, by requiring them to calculate taxes for approximately 10,000 distinct jurisdictions, each with their own rates, definitions, exemptions, and tax holidays. It also would subject businesses to audits by out-of-state tax authorities. It would lessen downward pressure on sales tax rates from tax competition, and threaten consumer privacy through states data sharing.

The Remote Transactions Parity Act of 2015 (RTPA) was introduced last year by U.S. Rep. Jason Chaffetz (R-UT). The bill adopts the same approach as the MFA by giving states unprecedented new powers to reach across their borders to tax businesses for online sales, but includes a few tweaks. Presumably, in an effort to address concerns about cross-state audits, the RTPA creates an option for sellers to use state-employed tax compliance agents.

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The bill attempts to protect sellers with gross receipts under \$5 million from being audited by other states, but then creates a loophole whereby a state can trigger an audit on a remote seller of any size by claiming “intentional misrepresentation.” It also contains a boiling frog-style rolling small seller exemption: In the first year, it exempts businesses with less than \$10 million in gross receipts for combined remote and in-state sales in the previous year. In the second year, the threshold drops to \$5 million, and in the third and subsequent years, it drops to \$1 million.

A hybrid origin sourcing option has been suggested by House Judiciary Committee Chairman Bob Goodlatte (R-Va). Under this plan, the seller applies his home domicile’s sales tax to remote purchases, then remits the tax (and the buyer’s zip code) to the seller’s home state. The states participate in a fund reimbursement program that channels revenue back to the buyer’s home taxing authority. This approach avoids the high compliance costs of the MFA and RTPA and preserves much of the healthy tax competition that currently exists. Unfortunately, it requires non-sales tax states’ businesses to collect and remit sales taxes, thereby compromising those states’ autonomy.

While Congress debates the issue, **many states are seeking to expand the definition of nexus** in order to trigger sales tax collection. These attempts, most notably California, New York, and Colorado, have been working their way through the courts with varying results. This is likely to continue until Congress acts.

Political State of Play

Polling shows that attempts to expand sales taxes on the Internet remain unpopular among Americans, especially among young adults. A [2013 Gallup poll](#) found 57 percent of all adults opposed an Internet sales tax, while 73 percent of 18 to 29-year-olds opposed one.

Proponents of MFA-style legislation include state and local governments and the associations that represent them. Expanded sales tax collection would be a boon to their coffers and spare them from politically unpopular budget cuts. Other supporters include big box retailers with a physical presence that triggers sales tax obligations in every state. Their calls for “fairness” notwithstanding, large retailers stand to gain a competitive advantage from the MFA’s disproportionate compliance cost burdens on smaller retailers.

Opponents of MFA-style legislation include officials of no-sales tax states who object to subjecting retailers to calculating, collecting, and remitting sales tax to other states. They view this as a states’ rights issue. The Direct Marketing Association and eBay have been vocal in opposition, worried that compliance costs would prove detrimental to their members or even force some to cease operations. Taxpayer watchdog groups, conservative and free-market think tanks, and fiscally conservative columnists have objected on principle.

For Further Reading

Forbes.com: [“The Real Reason Amazon Flip-Flopped On Internet Sales Taxes”](#)
The Wall Street Journal: [“The Internet Sales Tax Rush”](#)