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Why Internet Sales Taxes Bolster Bigger Government

A Primer on Leading Proposals and their Political Prospects

By Jessica Melugin*

The rapid growth of online retailing has led to calls from state and local officials for greater authority to capture more sales tax revenue, and 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 1992 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 retailers, it 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.

Rather than allowing states to collect taxes from out-of-state businesses, an origin-based system provides a more equitable and efficient approach to Internet sales that preserves healthy tax competition among states. Under an origin-based system, tax is assessed at the point of purchase, same as in a brick-and-mortar store. For example, if a Virginia resident goes online to buy socks from a California seller, that purchase is then taxed according to California’s tax rate and base and remitted to the Golden state. It is no different than if that Virginian flew to California to buy socks in person.

Leading Proposals

The Marketplace Fairness Act (MFA) would empower states to collect sales taxes 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 its own rates, definitions, exemptions, and tax holidays. It also would subject businesses to

* Jessica Melugin is an adjunct fellow at the Competitive Enterprise Institute.

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. It passed the Senate in 2013 and was reintroduced in the last Congress, but stalled in the House.

The Remote Transactions Parity Act of 2015 (RTPA) 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. 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. It was introduced in the 114th Congress by U.S. Rep. Jason Chaffetz (R-UT), but has failed to move forward.

A hybrid origin sourcing option has been suggested by House Judiciary Committee Chairman Bob Goodlatte (R-Va.). His plan would require sales be taxed in accordance with the tax base of the seller’s state—what is and is not subject to taxation—combined with the tax rate the buyer’s state has chosen for remote purchases. In practice, this means an Etsy seller shipping socks from California to a buyer in Virginia would a) determine if the socks are taxable by consulting California’s tax law and b) determine the rate by consulting Virginia’s tax rules. The sock seller would then remit the tax to California authorities, where those funds would be forwarded to a multistate clearinghouse and distributed by formula back to Virginia. The proposal is a marked improvement over the MFA, as it eliminates out-of-state audits and lowers compliance costs for sellers. Unfortunately, however, it allows states to export their tax regimes and thus curtails healthy interstate tax competition.

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, 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 provide a windfall 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 states with no sales tax, 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](#)"