



POLICY BRIEF

eTaxes

Internet and e-Commerce Taxation

Over the past decade, state lawmakers and tax administrators have increasingly sought new and innovative ways to tax internet transactions and e-commerce. With 46 states having overspent their budgeted revenue in 2009, and nearly as many projected to have similar overspending problems in 2010, eTaxes are becoming a favorite target of tax-and-spend legislators looking for more revenue.

There are currently four major state and federal efforts to implement eTaxes: the Amazon or “affiliate nexus” tax, the Streamlined Sales Tax Project, the Digital Goods tax, and taxes on internet access.

Amazon Tax (“Affiliate Nexus Tax”)

Current jurisprudence under the *Quill v. North Dakota* and *Bellas Hess* Supreme Court decisions says that states cannot require retailers to collect and remit taxes unless they have a physical presence or “nexus” in the state. Doing otherwise would be a violation of the Dormant Commerce Clause of the U.S. Constitution. The Amazon Tax, or “affiliate nexus tax,” allows states to reach well beyond their borders to require out-of-state companies to collect taxes on residents who buy virtually any good online. The tax presumes that a nexus is created in a state if an out-of-state company advertises through a link or advertisement on a website that is based in that state.

In addition to raising taxes on online consumers, the legislation clearly contradicts current law by exporting tax collection to out-of-state companies based on a highly dubious nexus with in-state advertisers. The measure is currently undergoing legal challenge in New York as contradicting *Quill*. While the state trial court dismissed the case – not ruling on the constitutionality of the eTax, but concluding that Amazon.com failed to state a claim – the dismissal is now being appealed.

Additionally, there is still a substantial burden for online retailers to determine which of more than 8,000 tax jurisdictions across the country a consumer is in and remit taxes collected to that jurisdiction.

The legislation also puts in-state businesses at a competitive disadvantage. In an effort to avoid the unconstitutional tax collection scheme, out-of-state retailers are terminating contracts with in-state advertisers, which range from small businesses to stay-at-home mom bloggers. Hawaii Gov. Linda Lingle and California Gov. Arnold Schwarzenegger have vetoed Amazon Tax bills because in-state advertisers were poised to lose revenue. Contrarily, Rhode Island passed the Amazon Tax resulting in online retailers rightly severing contracts with advertising affiliates to avoid collecting an unconstitutional tax. In addition to these advertisers losing a primary revenue source for their businesses, the state even projected retailers would sever this connection to avoid collecting the tax and thus scored the proposal as raising zero additional tax revenue for the state.

Streamlined Sales Tax Project (SSTP)

The Streamlined Sales Tax Project (SSTP) is an effort for states to participate in a national discussion about how to “simplify” and “streamline” their sales and use tax system. While a simpler and flatter tax code is something Americans for Tax Reform strongly supports, reform should always be done in a revenue neutral way, which SSTP does not accomplish. The effort consists of a tax-and-spend cartel that aims to extend tax collection to out-of-state vendors – online and catalogue retailers – and raise taxes through eliminating current exemptions and credits. Under the guise of simplifying the tax code, 23 states have opted to turn control of their tax code over to a small governing board of a few state lawmakers and tax administrators.

722 12th Street N.W.

Fourth Floor

Washington, D.C.

20005

T:(202)785-0266

F:(202)785-0261

www.atr.org

SSTP participating states have already raised taxes by over \$350 million. Under “use tax” law, consumers in most states are required to remit tax from out-of-state purchases. However, SSTP works to force companies with no physical presence or “nexus” in a state to collect and remit taxes instead.

Most importantly, SSTP eliminates tax exemptions and credits enacted by individual states, while simultaneously expanding the tax base by determining what products are taxable under certain definitions. For example, when Minnesota joined SSTP the state expanded its definition of “sales tax” to include shipping, handling, and postage. Now Minnesotans are forced to pay a new tax on goods purchased online or shipped. They also pay a higher price for goods from in-state vendors, as higher shipping costs are worked into a product’s price.

SSTP also raises constitutional concerns and poses a direct threat to federalism and state sovereignty. The Supreme Court decided in *Quill* and *Bellas Hess* that states cannot require businesses in other states that have no physical nexus to collect taxes, as this places an impermissible burden on interstate commerce. SSTP attempts to circumvent this nexus requirement by extending tax collection to remote sellers, placing the burden of tax collection on out-of-state businesses that have only a tenuous relation with the state. Additionally, for reasons discussed above, determining a consumer’s tax jurisdiction and remitting tax would be a significant burden.

State lawmakers – and not a small and distant body of tax administrators – should have the ability to determine their own tax laws. In addition to exporting the drafting of the tax code to out-of-state actors, SSTP exports the burden of collecting taxes to non-voting, out-of-state actors that have little ability to petition state governments.

While proponents argue SSTP helps level the playing field with brick-and-mortar retailers, it would do little to do so and could actually hurt “main street” retailers as well. According to the U.S. Census Bureau, e-commerce accounts for only 3.2% of total retail sales and

over 90% of these transactions are between manufacturers and wholesalers. While many business-to-business transactions are exempt from taxation, many are not. Taxing these transactions raises the cost of goods for main street retailers who buy at the wholesale level, as well as the price for the consumer. This also makes the tax less transparent for consumers.

Digital Goods Taxes

Eighteen states have imposed, either through legislation or unilateral regulation, taxes on digital or downloaded goods, including music, movies, books, and ringtones. While the tax can only be collected by in-state businesses, these efforts are multi-million dollar tax increases on e-commerce and in some states include taxes on software and vaguely defined “other digital goods.”

Digital goods taxes also put states at a competitive disadvantage. Four states (North Dakota, Oklahoma, Ohio, and Minnesota) have specifically exempted these goods from taxation to drive digital vendors and other high tech companies to their states. California even rejected a digital goods tax bill in 2008 for this very reason.

Wherever there’s a tax, there’s a black market, and one of the largest black markets today is digital downloads. Piracy of online goods runs rampant on the internet and these bills will incent illegal downloading and further impede property rights. Studies show that nine out of ten music downloads are obtained illegally and that 40 percent of revenue lost by the film industry can be attributed to online piracy.

Internet Access Tax

The federal Internet Tax Freedom Act was recently reauthorized in 2007 to prevent states from levying any new taxes on internet access. Despite this federal preemption, some states are continuing efforts to tax the internet. In 2009, for example, the Louisiana legislature unsuccessfully pushed a \$2.4 million tax hike on internet access by calling it a fee.