

# AMERICANS *for* TAX REFORM

Statement of

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**U.S. Senate Committee on Commerce, Science, and  
Transportation**

**“Marketplace Fairness: Leveling the Playing Field for Small  
Business”**

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## **Introduction**

Chairman Rockefeller, Ranking Member Hutchison, and Members of the Senate Commerce, Science, and Transportation Committee, thank you for the opportunity to submit written testimony on behalf of Americans for Tax Reform on the issue of remote state sales tax collection and physical presence.

Americans for Tax Reform advocates for a system in which taxes are simpler, flatter, more visible, and lower than they are today. However, ATR is concerned that the Marketplace Fairness Act (S. 1832), sponsored by Sens. Dick Durbin (D-Ill.) and Mike Enzi (R-Wyo.), would not only raise tax revenue on net for states, but also fail to adequately simplify the tax code and erode the physical nexus standard that protects Americans from the tax laws of other states.

Under the U.S. Supreme Court's ruling in *Quill v. North Dakota*, it is a violation of the Commerce Clause for a state to require an online or remote retailer without a physical presence in that state to collect and remit the sales tax. This is not a "tax loophole" as some would suggest, but law derived directly from the U.S. Constitution. The Marketplace Fairness Act would overturn the *Quill* decision, permitting overzealous state tax collectors to reach well outside their borders to force online and other out-of-state retailers to collect their state's sales tax.

The effects on taxpayers of the Marketplace Fairness Act and similar legislation would be dramatic. From a taxpayer perspective, any bill that touches remote sales taxes must preserve the physical presence standard and protect consumers on net from a higher tax burden. Unfortunately, the federal online sales tax bills miss the mark widely on both fronts.

## **State-level Tax Burden Will Increase**

Proponents of federal Internet tax legislation repeatedly claim that the measure is not about new taxes. The Marketplace Fairness Act even includes a section called "No New Taxes," which enshrines little into law except rhetoric. Yet, proponents are also quick to point out that it would raise as much as \$23 billion in tax revenue from consumers at the state level.

While consumers do currently owe "use tax" on products they purchase online and out-of-state, compliance is scant and most states have failed to even undertake basic enforcement mechanisms, such as including use tax collection on income tax forms.

Yet, use tax is simply not the same as a sales tax, which is actually owed by retailers that may legally pass the tax liability onto consumers. Where they do find common ground is their basis in the current physical nexus standard: businesses with a physical footprint in a state remit "sales tax," and consumers with footprint remit "use tax."

The Marketplace Fairness Act would force out-of-state retailers to collect and remit sales taxes – to say nothing of consumer-paid use taxes. This is a fundamental change in tax law and certainly a new form of taxation. Furthermore, for the numerous retailers who do not pass sales tax liability onto their consumers at the register, this legislation amounts to a new out-of-state tax that will come directly out of a business's bottom line.

Proponents also claim remote sales are “eroding” the sales tax base and without federal action states will raise other taxes to compensate for a drop in revenues. First, this grossly overstates whatever problem might exist. According to one study, this so-called erosion amounts to “less than three-tenths of one percent of state and local tax revenues.”

Second, it ignores that states can also solve budget shortfalls by cutting spending. As GDP plummeted during the last recession, states increased spending by 8.4 percent. Fiscally responsible lawmakers should not be encouraging states to engage in such profligate spending by pushing for a measure that will raise as much as \$23 billion in tax revenue at the state level.

### **Dissolving Physical Nexus Weakens a Fundamental Taxpayer Protection**

The physical nexus standard is a staple of our tax code, preventing states from reaching across their borders to force out-of-state businesses or individuals to comply with their tax codes – whether it be collecting, remitting, or even paying taxes. The Marketplace Fairness Act will dissolve this physical nexus requirement for collecting sales taxes.

The Marketplace Fairness Act also opens the door – at least to conversation – about other forms of “economic nexus” standards that would permit states to apply their tax codes to non-residents with mere economic presence in the state. Codified in many different forms across the country, the economic standard grants nebulous authority to force out-of-state, non-residents to comply with a state’s tax code. The gradual shift to economic nexus is an attempt by states to raise tax revenue beyond what their own economies and taxpayers can sustain.

Economic nexus poses a direct threat to the principle of republican governance by the people, shifting the cost of government to non-residents. It also violates the “benefits principle” by pushing the tax burden onto those that receive no direct benefit from the state.

To put it simply, measures to dissolve the physical presence standard have the potential to usher in the second coming of taxation without representation in America.

### **Outsources State Tax Rules to an Unelected Body**

Under the Marketplace Fairness Act, twenty-four states operating under the Streamlined Sales and Use Tax Agreement (SSUTA) would be able to tax remote sales almost automatically. Remaining states would have to comply with a number of requirements or choose to join the Streamlined Sales Tax Project (SSTP).

Reliance on SSUTA allows a handful of tax administrators and state lawmakers on the Streamlined Sales Tax Governing Board – which has long advocated for tearing down the physical nexus standard for sales taxes – to control remote sales tax decisions for states and incents the states that are not part of SSUTA to join. Non-SSUTA states will watch helplessly as the “streamline states” hassle their resident businesses to collect more tax revenue.

### **Tax Code Complexity Will Increase**

The Marketplace Fairness Act will force online, catalog, TV and other remote retailers to comply with over 9,600 sales tax jurisdictions across the country. Firstly, whatever un-level playing field for tax collection does exist would be perpetuated – not resolved – by the Marketplace Fairness Act. In fact, the scales would be tipped against remote retailers, who would have to comply with the 9,646 tax jurisdictions across the country, while brick-and-mortar stores would comply with only the one where they are located.

While SSTP purports to simplify the tax code, the Marketplace Fairness Act's reliance on it will further increase complexity. Since SSTP's creation over a decade ago, the number of sales tax jurisdictions across the country has skyrocketed. The roughly 8,000 tax jurisdictions in existence in 2009 have risen to 9,646 today – with an average of 651 new or different sales tax rates or jurisdictions every year.

Additionally, by attempting to define very specific goods and services, SSTP's pursuit of uniformity between state tax codes has created even worse complexity. For example, SSTP has long struggled with defining specific products, such as “candy” and “cereal” that can both contain very similar ingredients. Such Platonic collection-and-division-style tactics by SSTP to create uniformity and simplicity not only create enormous complications in our tax codes but also are by design destined for failure. Instead, states should work toward the opposite end: scrapping definitions for individualized goods and services.

SSTP also allows for diverse and discriminatory tax rates on various goods, even to the point of carving out exceptions for various member states. Defining goods more generally instead of individually would also help to eliminate discriminatory state and local tax rates on specific goods.

While it is true that software – if frequently updated – could calculate the sales tax rate for each jurisdiction, software cannot keep track of the varied definitions for taxing goods and can hardly advise a retailer of these complex determinations. A computer cannot, for example, determine if a KitKat bar should be considered “candy” or more generally as “food,” since items that contain flour under SSTUA are not considered candy. This is but one example of controversial determinations made by SSTP.

### **Preserving Physical Nexus and Preventing a Higher Tax Burden**

Instead of pursuing the Marketplace Fairness Act, Congress should look toward strengthening the physical presence standard, which is being slowly eroded by revenue-hungry states. With regard to remote sales, origin-based sourcing – whereby tax is based on the jurisdiction of the seller rather than the buyer – is one option to preserve the physical nexus standard while addressing remote sales.

Regardless of the path, any effort to tax remote sales must preserve physical nexus and be made revenue neutral at the state level to ensure that the net tax burden on consumers does not rise.

The Senate should also take up legislation that would help to strengthen the physical presence standard in other ways. Lawmakers should consider the Business Activity Tax Simplification Act, or BATSA (H.R. 1439), which has been introduced in the U.S. House of Representatives by Rep. Bob Goodlatte (R-Va.).

BATSA establishes a clear physical presence standard for taxing multistate businesses engaged in cross-border transactions. The bill will help to foster inter-state economic activity by eliminating the burden for businesses of having to comply with varying and complex state income tax laws. As Congress considers measures like the Marketplace Fairness Act and as nearly half of states have already sought to loosen their physical nexus standard, BATSA could not come at a more critical juncture.

### **Conclusion**

Congress has well-established Constitutional authority to regulate interstate commerce and related tax laws. However, with that tool in mind, it is critically important that Congress work toward lowering the tax burden and strengthening the physical nexus standard that was reaffirmed in *Quill v. North Dakota*. Unfortunately, the Marketplace Fairness Act and similar measures under consideration by Congress today would do the opposite.