



Implications of the Internet Sales Tax

Internet sales as a percentage of total retail sales have grown from 2 percent in 2000 to 16.1 percent today, with a value of \$4.1 trillion, according to the Federal Reserve Bank of St. Louis.^[1] This massive revenue source has caught the attention of governments looking to meet budgets because many of these transactions are not subject to state and local sales taxes.

Taxing internet sales has largely been restrained by the 1992 Supreme Court case *Quill Corp. v. North Dakota*, which ruled that collection of sales taxes from remote vendors was an unconstitutional burden on interstate commerce and that states could only tax companies with a physical presence within the state.^[2] This in turn led to larger companies with internet sales to strategically placing their warehouses and offices to avoid higher taxes, a notable example being Amazon's warehouse in low-tax Nevada being used to deliver to customers in high-tax California.^[3]

The ability of internet sellers to avoid state sales taxes has prompted the introduction of the Marketplace Fairness Act in Congress, which would empower states to collect online sales taxes.^[4] This is in line with the *Quill* ruling as the Court said Congress could grant states the power to collect online sales tax.

An internet sales tax will undeniably increase how much consumers pay for what they order online. For Nebraskans, the increase would include the 5.5 percent state sales tax and the local sales tax, which can run as high as 2 percent under state law.^[5] So some Nebraskans would pay up to 7.5 percent more for online items. Although, Nebraskans are currently required to report their online purchases and remit the amount owed directly to the state,^[6] but it is unclear how effective these requirements are in compelling compliance. It is also unclear how well-known the requirement is among the general population.

Effects on consumers tie directly into the costs for businesses. The higher costs will inevitably result in fewer people shopping online. In a 2000 study, Austan Goolsbee—a chief economist for President Obama—estimated that taxing online sales would make them decrease by 24 percent.^[7] Apart from lost revenue due to decreased sales, businesses would also have the daunting task of collecting taxes for the states their customers live in. There are roughly 9,600 jurisdictions with the authority to impose sales taxes, and businesses selling online would have to comply with each one.^[8] While the bill would allow businesses to file a single return for all taxing authorities within a state, that still means businesses would have 46 potential returns—45 sales tax states and Washington D.C.—that would be filed monthly or quarterly depending on the state.^[9] Additionally, each state would be able to audit a particular business once a year, which

means a single business could face up to 46 potential audits every year.^[10] While these requirements and the immense costs associated would likely be no problem for large businesses like Amazon, it would have a substantial impact on smaller businesses like the Norfolk-based online ATV parts company Powersports Nation.^[11] In effect, these requirements and regulations could help larger sellers like Amazon crowd out their smaller competitors who would both lose business from lower consumer spending and be unable to calculate the thousands of taxing jurisdictions; deliver dozens of returns on a monthly or quarterly basis; and deal with potentially numerous audits every year.

There is also a states' rights issue to consider, as the legislation would force businesses in states without sales taxes-Alaska, Delaware, Montana, New Hampshire, and Oregon^[12]-to collect taxes for other states even though the business owners and employees have no say in those states' tax policies. Some have even labeled this a modern form of "taxation without representation."^[13]

On the other side of the argument, there is a fairness argument that internet sales should be subject to the same taxes and regulations as regular businesses. The lack of sales tax gives internet sellers a distinct advantage over brick-and-mortar retailers as their goods are less expensive and therefore more attractive to consumers. The Marketplace Fairness Act would not create any new taxes; it simply makes internet sellers subject to taxes that already exist.^[14]

Even though it would "level the playing field," the tax compliance burdens are of concern, and some suggestions have been put out to make an internet sales tax workable and less burdensome. In a 2011 paper, economists Veronique de Rugy and Adam Thierer of the Mercatus Center at George Mason University recommended "[a]n origin-based sourcing rule" where customers would pay the sales taxes of the state where the company they are buying from is located. This is based on the idea that a visitor to a state pays the taxes of that state, not of their home state.^[15] For example, if a Nebraskan went to Iowa and bought something, they would pay Iowa taxes; similarly, if a Nebraskan bought online from an Iowa based company they would pay Iowa taxes under the origin-based sourcing rule. This process would simplify the process and eliminate the constitutional concerns of "taxation without representation" as well as foster tax competition as businesses would try to put themselves in low-tax environments, encouraging states to lower their tax burdens.^[16]

It is also important to evaluate how an internet sales tax would affect Nebraska. A 2010 study conducted by Empiris LLC estimated that had there been an internet sales tax in 2008 with an exemption for small businesses making less than \$5 million-the Marketplace Fairness Act has a small business exemption for those making less than \$1 million^[17]-then Nebraska would have collected an extra \$17.5 million. Without the small business exemption, the state would have collected \$25.5 million.^[18] To put that in perspective, those amounts would have been 1 and 1.4 percent, respectively, of the sales tax revenue brought in for fiscal year 2008-2009.^[19]

While taxing internet sales like regular sales would "level the playing field," the way the Marketplace Fairness Act would impose an internet sales tax would do far more harm than good. The regulations and requirements of this Act would be detrimental to many small and medium sized businesses, and will simply help big businesses like Amazon and Walmart to keep smaller competitors out of the market. In short, it is big government helping big business; a visible demonstration of crony capitalism. The better solution for states to collect online sales tax would

be to make sure citizens know the requirements for reporting their online purchases and remitting those taxes. If states and Congress feel such measures are inadequate, then the most reasonable course of action would be to adopt the "origin-based" internet sales tax proposed by Rugs and Thierer of the Mercatus Center. This idea would both allow states to collect internet sales revenue and avoid placing an incredibly heavy burden upon small businesses.

As our economy becomes more online-based, it will become necessary to integrate internet sales into existing sales tax codes. However, the Marketplace Fairness Act is the wrong way to do it.

[1] Federal Reserve Bank of St. Louis, "Graph: E-Commerce Retail Sales (ECOMSA)/Retail Sales: Total (Excluding Food Services) (RSXFS)," Economic Research, Federal Reserve Bank of St. Louis, 2013. Accessed May 3, 2013, <http://research.stlouisfed.org/fred2/graph/?g=hKC>. Steven Maguire, "State Taxation of Internet Transactions," Congressional Research Service, April 19, 2013. Accessed May 5, 2013, <http://www.fas.org/sgp/crs/misc/R41853.pdf>.

[2] John Paul Stevens, "Quill Corporation, Petitioner v. North Dakota by and through its Tax Commissioner, Heidi Heitkamp," United States Supreme Court Majority Opinion, May 26, 1992. Accessed May 5, 2013, <http://www.law.cornell.edu/supct/html/91-0194.ZO.html>. It should be noted that the *Quill* decision supported an earlier 1967 decision *National Bellas Hess v. Illinois Department of Revenue*, where the court held that the many different variations in rates and exemptions placed too great a burden on sellers-and interstate commerce in general-to have to force businesses to pay the sales taxes of their distant, out-of-state customers.

[3] Ken Doctor, "The newsonomics of Amazon vs. Main Street," the Neiman Journalism Lab, July 26, 2012, Nieman Foundation, Harvard University. Accessed May 5, 2013, <http://www.niemanlab.org/2012/07/the-newsonomics-of-amazon-vs-main-street/>.

[4] Marketplace Fairness Act, "About." Accessed May 5, 2013, <http://www.marketplacefairness.org/what-is-the-marketplace-fairness-act/>.

[5] Nebraska Department of Revenue, "Current Local Sales and Use Tax Rates," April 1, 2013. Accessed May 5, 2013, <http://www.revenue.ne.gov/question/sales.html>.

[6] Nebraska Department of Revenue, "Frequently Asked Questions about Nebraska Sales and Use Tax." Accessed May 5, 2013, http://www.revenue.ne.gov/question/slstax_faq.html#s10.

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[9] Megan McArdle, "The Real Problem With the Internet Sales Tax," April 24, 2013, *The Daily Beast*. Accessed May 5, 2013, <http://www.thedailybeast.com/articles/2013/04/24/the-real-problem-with-the-internet-sales-tax.html>.

[10] Jacob Sullum, "Are Online Sales Taxes Only Fair?" *Reason*, May 1, 2013. Accessed May 5, 2013, <http://reason.com/archives/2013/05/01/are-online-sales-taxes-only-fair>; T. Elliot Gaiser, "Internet Sales Tax: Here Come the Auditors," Heritage Foundation, April 29, 2013. Accessed May 5, 2013, <http://blog.heritage.org/2013/04/29/internet-sales-tax-here-come-the-auditors/>.

[11] T. Elliot Gaiser, "Internet Sales Tax: Here Come the Auditors," Heritage Foundation, April 29, 2013. Accessed May 5, 2013, <http://blog.heritage.org/2013/04/29/internet-sales-tax-here-come-the-auditors/>; Powersports Nation, "About Us." Accessed May 5, 2013, <http://www.powersportsnation.net/aboutus.asp>.

[12] Tonya Moreno, "States Without a Sales Tax," September 28, 2010. Accessed May 6, 2013, <http://taxes.about.com/od/statetaxes/a/States-Without-A-Sales-Tax.htm>.

[13] Jim Meyers, "Opposition to Internet Sales Tax Bill Grows as Vote Looms," April 22, 2013. Accessed May 6, 2013, <http://www.newsmax.com/Newsfront/internet-sales-tax-senate/2013/04/22/id/500706>; T. Eliot Gaiser, "Internet Sales Tax Hits Consumers Online," Heritage Foundation, April 22, 2013. Accessed May 6, 2013, <http://blog.heritage.org/2013/04/22/internet-sales-tax-hits-consumers-online/>.

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[16] Ibid.

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[19] Calculations by author, 2008-2009 fiscal year revenue from Nebraska Department of Revenue, "Comparison of Actual and Projected General Fund Receipts by Tax Type for June 2009 and Cumulative Fiscal Year 2008-2009," July 10, 2009. Accessed May 6, 2013, http://www.revenue.ne.gov/research/gen_fund/nr0709.html.

