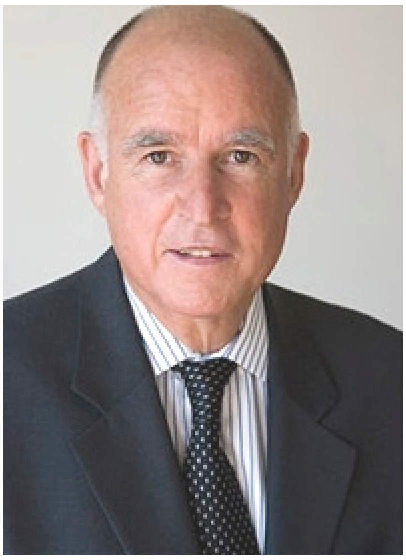
Internet Sales Tax Collection Gaining Momentum



When California Governor Jerry Brown (left) signed into law that state?s latest attempt to collect Internet sales taxes from retailers outside the state, he surely must have known he would be hurting, perhaps eliminating altogether, at least 25,000 small businesses. But the opportunity to collect an estimated $200 million in uncollected taxes overrode that consideration.

Amazon.com, with gross sales of $34 billion annually, generates much of its revenues through affiliates who offer the opportunity to their customers to click through their websites and purchase products from Amazon. In an email sent to its California affiliates on Tuesday, Amazon said:

Unfortunately, Governor Brown has signed into law the bill that we emailed you about earlier today. As a result of this, contracts with all California residents participating in the Amazon Associates Program are terminated effective today, June 29, 2011.

Jonathan Johnson, President of O.co, also known as Overstock.com, announced a similar move, terminating hundreds more. He said, We think this law is unconstitutional. But rather than fight it in every state, its just easier to terminate the affiliates and let [those] business[es] migrate elsewhere. Added O.cos vice president and general counsel Mark Griffin,

> What these legislators dont seem to understand is that in every state thats enacted such a law, we have discontinued our relationship with our affiliates and it hasnt affected our business at all. Its unfortunate that some of them go out of business, but these lawmakers are putting us in a position where we have no choice. We understand the difficulty it creates for our affiliates, but its not a difficult decision for us to make.

The California law is an attempt to work around the 1992 Supreme Court case *Quill Corporation v. North Dakota,* which held that states could collect Internet sales taxes only from out-of-state retailers with a physical presence a nexus in California. A presence such as an office or a warehouse would qualify as a nexus. But affiliates would not. The new law now reaches to those affiliates as well as any other relation an out-of-state retailer might have, such as a design studio, or ownership of a different business inside the state.

The termination of affiliate relationships will cost California at least $150 million in state income taxes, according to Rebecca Madigan, executive director of the trade group Performance Marketing Association. Many of the larger affiliates will be forced to move out of state, taking with them the income taxes they would otherwise pay. She added, This law will actually generate less than zero for California. The chief executive of one such affiliate, Loren Bendele of Savings.com, said, We have to consider [moving]. It does not look good for our business.

On the other side of the issue, the *Los Angeles Times* noted that not collecting sales taxes [gives] Internet retailers a competitive price advantage over Californias small businesses such as independent booksellers and big-box retailers with a presence in the state. Bill Dombrowski, president of the California Retailers Association and supporter of the new law, explained that you cant give one segment of retail a 10% discount every day. Its just not fair.

Other states have implemented similar though less stringent laws, including New York, Illinois, Rhode Island, North Carolina, and Colorado, with several states considering them: Arizona, Hawaii, Minnesota, Mississippi, and Vermont.

The prize is worth the gamble, with consumers purchasing an estimated $250 billion online every year, and thus far avoiding sales taxes upwards of $25 billion. Texas where Amazon does have a physical presence (a distribution center) is suing the retailer for some $269 million in sales taxes. Illinois just passed a law classifying affiliates as physical locations and thus requiring online retailers to collect taxes and remit them to the state. The Vermont House of Representatives just passed a similar law and sent it to the state Senate for concurrence.

The clock is ticking down for Amazon and other online retailers as momentum for taxing all online sales continues to build. The Streamlined Sales Tax Governing Board, founded in 1999, has been pushing for a coordinated sales tax collection process among the states. At present, 24 of the 44 states (with sales taxes) have already passed the conforming legislation, and the board is merely waiting for appropriate federal legislation to allow all states to collect sales taxes no matter where the retailer may be located. As noted on their website:

> Only Congress has the authority to let states require collection of the billions of dollars in uncollected sales tax. Now that these states have made tax collection simple and easy for retailers, Congress can adopt legislation that applies to [all] the products and services sold by remote sellers.

Sure enough, Senator Dick Durbin (D-Ill.) has announced just such legislation, called The Main Street Fairness Act, designed to allow the states to collect [sales] taxes that are already owed under current law regardless of whether the seller has a physical presence in the state [or not]. Durbin said:

> The Main Street Fairness Act doesnt ask anyone to pay a single penny more in taxes. Instead, it would help governors and mayors collect taxes that are already owed. Between 2009 and 2012, statesare expected to lose as much as $37 billion in uncollected state and local taxes on internet and catalog sales. From 2005 to 2010 the state of Illinois estimated it lost $153 million each year.

Any movement to level the playing field by eliminating sales taxes across the board is, at the moment at least, invisible. The states are so hungry for revenues to attempt to balance their precarious budgets that any source of uncollected sales taxes looks awfully attractive. Competition between states for best practices envisioned by the Founders of the republic is being eliminated in an attempt to simplify the tax collection process and collect those unpaid taxes that online consumers have enjoyed for so long.