STATEMENT OF THE
DIRECT MARKETING ASSOCIATION
REGARDING THE
COMMITTEE ON JUDICIARY
OF THE
UNITED STATES HOUSE OF REPRESENTATIVES
HEARING ON
MARKETPLACE EQUITY ACT OF 2011
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I. INTRODUCTION

The Direct Marketing Association (DMA) thanks Chairman Smith and Ranking Member Conyers for this opportunity to present its views on the Marketplace Equity Act of 2011, H.R. 3179, which would allow states to impose tax and tax collection obligations on retailers located outside of those states and that have no physical presence in those states. The bill would grant states the authority to conscript non-citizen businesses to become their tax collectors. These efforts are not federal tax reform—they are not state tax reform. These efforts represent a request from states that Congress impose a 1930's tax regime on 21st Century commerce rather than reforming their tax regimes.

DMA is the leading global trade association of businesses and nonprofit organizations using and supporting direct marketing via channels including mail, telephone, direct TV, radio and the Internet. Founded in 1917, the DMA currently has over 2,000 member companies across the United States and 53 foreign countries.

DMA would like to discuss the history of state efforts to require remote (out-of-state) sellers to become unpaid tax collectors for states, including the Streamlined Sales and Use Tax Agreement (SSUTA), and H.R. 3179.

II. HISTORY: STREAMLINED SALES AND USE TAX AGREEMENT (SSUTA)

The U.S. Supreme Court in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), ruled that without specific authorization from Congress, states could not impose tax collection burdens upon remote sellers that have no "physical presence" as this would interfere with interstate commerce. Moreover, if allowed by Congress, the myriad of state tax jurisdictions with resulting variance in rates, definitions, and audits would create a complex and administratively costly nationwide sales tax collection system. The costs of that collection are a tax on the out-of-state business. It is significant that these remote sellers' businesses do not receive police or fire protection from those states—they are not present in them. Their employees and their families do not receive educational or social services from those states—the businesses have no employees located in those states.

Governments, as well as businesses, face challenging financial decisions in these economic times. State legislatures have very difficult budget determinations and are looking at both cutting costs and increasing revenues. However, proponents of the SSUTA have cited grossly exaggerated revenue estimates of uncollected sales and use taxes due to remote sales. In particular, proponents have cited a University of Tennessee study conducted in 2000 that includes unbelievable estimates as to the amount of the uncollected sales tax. A revised Tennessee study lowered its initial estimate from $45 billion to $24 billion—even the revised estimates will not be realized.

It is important to note that the Tennessee study rests on a number of faulty assumptions and is not based on U.S. Government data. Further, the study's implication that states are "losing" a substantial portion of their sales tax revenues to electronic commerce is simply false. The vast majority of e-commerce transactions are not with consumers, but rather with businesses, and such business transactions almost always are subject to tax collection or direct payment of use taxes by the purchaser. Moreover, the marketplace is demanding more rapid delivery of purchased goods. To keep those sales, marketers are establishing more and more distribution centers throughout the country establishing nexus under *Quill* in more and more states. The "lost" tax revenue is shrinking—not growing—due to market demand.

In contrast to the Tennessee study, the independent firm, Forrester Research, has estimated that the loss of tax revenue due to state residents not paying use taxes for remote sales is $3 billion nationwide—a fraction of the $24 billion estimated in the revised Tennessee study. A 2007 DMA-commissioned study, based on U.S. Commerce Department data, estimates that in 2006 uncollected sales tax nationally totaled $4.2 billion. A 2010 study by Eisenach-Litan found that uncollected taxes in 2008 totaled $3.9 billion. There is no $24 billion pot of gold.

In light of the *Quill* decision, the states began a project to simplify the sales tax regimes that a remote seller would face if required to become the foreign state's tax collector. The SSUTA goal was to remove that complexity and create a 21st century, Internet-friendly tax regime to encourage economic growth throughout the national marketplace. However, the SSUTA has failed to either remove complexity or create that 21st century tax policy standard. To be blunt, the SSUTA is a document drafted by tax administrators, and, as might be expected, it has resulted in little in the way of tax simplification.

Specifically, the SSUTA:

- Has not reduced the number of sales tax jurisdictions in the Nation, which currently number over 9,600;
- Has not reduced the number of state and local sales tax rates;
- Has not reduced the number of audits to which an interstate seller would be subject (each state revenue department would still conduct its own independent audit);
- Has not established a long-promised uniform vendor compensation to cover the

substantial cost of tax collection; and
- Has not established a single remittance procedure.

Moreover, the Governing Board of SSUTA has granted exceptions to its feeble simplification initiatives to win approval of the states. Recently, the Board granted an exception from the SSUTA-defined rule for Massachusetts when calculating the sales tax on articles of clothing over $100. SSUTA will continue to grant exceptions that will increase the complexity of sales tax collection. States are enacting sales tax holidays—some for all purchases under a capped price; others for specific products (such as hurricane preparedness) on a specific date. Those actions, while important for the state and its citizens, further complicate a nationwide sales tax collection regime.

As you can see, tax collection has not been simplified since the inception of SSUTA. In fact, SSUTA is "streamlined" in name only.

To better appreciate the failings of the SSUTA, it is instructive to consider its history. The Streamlined Sales Tax Project was launched in 2000 on the heels of two earlier joint government/industry initiatives: the National Tax Association (NTA) Communications and Electronic Commerce Tax Project, and the Congressionally-established Advisory Commission on Electronic Commerce. Both projects had concluded that the existing state sales tax system was one of daunting complexity, and that true simplification would require sweeping reforms.

Perhaps most emblematic of the SSUTA's failure to achieve genuine sales tax reform was the early demise of the single-most important step toward simplification: the adoption of a single sales tax rate per state for all commerce (both over-the-counter sales and interstate sales). Had the SSUTA adopted this so-called "one rate per state" proposal, this single act could have eliminated the problem of merchant compliance with thousands of local tax jurisdictions with different tax rates.

To put this "one rate per state" issue in perspective, the United States is the only economically developed country in the world with a system of sub-state transaction taxes, not only for counties and municipalities, but also for school districts, transportation districts, sanitation districts, sports arena districts, and other local jurisdictions. In light of this wildly complex system, the adoption of the "one rate per state" standard was the *unanimous* recommendation of the NTA's E-Commerce Project (which included delegates of the National Conference of State Legislatures, National Governors Association, and US Conference of Mayors) and was in the majority report recommendation of the Congressional Advisory Commission.

Those failings increase the burden on out-of-state sellers. Being subject to 45 separate state audits requires a tax department. Those businesses would be required to have multiple state registrations and multiple remittance procedures. The cost stemming from tax collection would be passed to consumers, constituting an anti-stimulus at a time when our nation is working to stimulate the economy. Moreover, remote sellers with locations only in states that do not impose sales taxes, and that, in turn, have no process in place to collect any sales taxes, would be required to create an entirely new tax department within their company and establish entirely new accounting and ordering protocols. Those remote sellers would face even greater burdens.

Any discussion of tax reform concerning non-citizen companies becoming tax collectors for states, should require tax reform in terms of simplification of state sales tax regimes. Only after that reform should Congress consider granting additional interstate taxing authority to the states with the *proviso* that the tax regime simplification must remain in place.

III. H.R. 3179: THE MARKETPLACE EQUITY ACT

The Marketplace Equity Act attempts to mitigate the significant burden forced sales and use tax collection places upon non-citizens of a state. It fails to reduce the tax burden placed upon remote sellers. The bill grants states three "simplified" alternatives:

- Require collection of a single blended sales tax rate for use in remote commerce; or
- Require collection of the highest sales tax rate in the state exclusive of local tax rates; or
- Require collection of the applicable state and local sales taxes with the state making available adequate computer software to the remote seller and exempting a seller using the software from state liability for incorrect collection.

Experience with the Streamline Sales Tax Agreement indicates that states will choose the latter alternative. States have failed for the past 10 years to reach agreement on single tax rates within a state. With the alternative to require collection for 9,600 tax jurisdictions on the table, that will be the option of choice.

Even the Streamline Sales Tax Agreement calls for states to provide collection software to remote sellers. This represents a cavalier conclusion that providing software is the answer to the tax burden imposed when states conscript non-citizen remote sellers to become their tax collectors (unpaid collectors under H.R. 3179). Tax collection software is not a simple plug-in. Many remote sellers use specialized software for order, fulfillment, billing and inventory control. That software must be up and running 24/7. Adding additional tax collection software cannot cause any down-time for the seller. This adds significant cost to implement any software. Moreover, the tax collection software must be continually updated as states consistently throughout the year tweak their sales tax laws. One Internet based company has testified that the cost to implement sales tax collection in one state cost over $1 million, including work hours. Marketers cannot afford that cost. Thus, the requirement that states make available adequate software does not significantly reduce the burden on interstate commerce notwithstanding what proponents of H.R. 3179 claim. In addition, each state could make available different software—a true administrative nightmare.

H.R. 3179 also fails to address the burden of 46 potential audits (45 states and the District of Columbia). Remote sellers would be required to have a tax audit department and legal counsel at the ready for auditors representing 9,600 taxing jurisdictions. Unlike citizen companies, non-citizen remote sellers would be required to go to courts in states where they have no political voice to resolve any disagreements with state auditors over their tax collection. H.R. 3179 should, at least, repeal the Tax Injunction Act as it applies to disputes on tax collection with non-citizen remote sellers.

H.R. 3179 also fails to address other administrative burdens for non-citizen conscripted tax collectors:

- There is no provision concerning tax holidays that many states have for specific items, such as back-to-school and hurricane preparedness.
- There is no single, uniform rule for sourcing all transactions in a state.
- There is no mechanism to prevent caps and thresholds on taxable items.

The bill does relieve remote sellers from liability of state claims if the seller uses the state "available" software. However, remote sellers are liable for consumer claims (some coming as class action claims) for errors in sales tax collection. H.R. 3179 provides no shield from those claims for remote sellers even when using state "available" software.

The first two alternatives in H.R. 3179, although DMA believes states will not choose them, create for the first time a different legal sales tax rate for remote sales *vis-à-vis* retail sales. Although today non-citizen remote sellers are not required to collect sales tax, the consumer is liable for that tax—the same tax that is applied to retail sales in the consumer's jurisdiction. H.R. 3179 would create a different tax rate—some higher than the retail tax rate and some lower. To DMA's knowledge, this is a first—with its own legal considerations.

H.R. 3179 assumes that the seller calculates the tax for the consumer and includes the tax in the amount charged. DMA has many members whose customers still pay by check and calculate the shipping and would calculate the sales tax themselves. In practice it is impossible for a remote seller to provide the check payer (who likely orders *via* the U.S. Mail) with the tax rates for 9,600 jurisdictions. Moreover, when faced with an incorrectly calculated tax on a check order, the seller faced with an overpayment must either provide a refund or credit and contact the customer with that information and choice which is very costly. With an underpayment of tax the seller is faced with an even more difficult and costly choice. The seller may hold the order and request further payment from the customer or may simple pay the additional tax itself (a new tax burden). DMA knows of a company located in a state with numerous local sales tax rates that simply asks consumers paying by check to remit the state sales tax and it pays the local sales tax to avoid customer confusion. Administrative burden is not washed away by computer software.

The Marketplace Equity Act does not provide for any compensation for non-citizen remote sellers. Passage of the Act would eliminate any further discussion on compensation. It is important to remember that these sellers are non-citizens of the state and are being conscripted to become tax collectors for that state. Compensation would be one facet of equity.

IV. CONCLUSION

The bright-line physical presence test in *Quill* should remain for collection of sales and use taxes without significant simplification reform of state sales tax regimes. The burden of each on interstate commerce is large, and this is a time when our economy can ill afford such a burden.

DMA urges Congress both to uphold the physical nexus standard of *Quill* rather than extending taxing authority of states to include the collection of sales and use tax beyond their borders without significant simplification reform by the states.