

Streamlining Versus ‘Amazon’ Laws: The Remote Seller Dilemma

by Cara Griffith

Practice Notes is a column by Cara Griffith, who was a legal editor for State Tax Notes before taking a position as a manager with PricewaterhouseCoopers LLP. She is now a freelance writer focusing on how practitioners are addressing state tax issues facing clients.

“The present system of State taxation as it affects interstate commerce works badly for both businesses and States.” — Willis Commission Report, 1965

There are many reasons that electronic commerce exploded in the past decade. The e-commerce business model enables remote sellers, even very small ones, to operate in one state and have customers in other states or even other countries. For consumers, in addition to having or benefiting from the simple convenience of online shopping, the Internet has enabled them to search many vendors before making a purchase. Nearly any item can be located and prices compared. It’s a bargain shopper’s delight. And even though the overall growth of online retail sales was down by 0.7 percent in 2009, eMarketer Inc. predicts that online sales will return to growth in 2010 and will grow by double digits in 2011. The company estimated that in 2009, e-retail sales totaled \$131.4 billion and that by 2011 that amount will have increased to \$157.6 billion.¹

Despite the benefits of e-commerce, sales by remote sellers via the Internet present a significant problem for state tax officials: If a remote seller has no physical presence in a state, the seller is not obligated to collect and remit that state’s sales tax. And although consumers are technically obligated to pay use tax on online purchases, those remittances rarely are paid. The result is that states fail to capture sales tax revenue on many out-of-state sales by remote sellers. States, however, have shown they

are unwilling to simply roll over and accept a loss of sales tax revenue. Instead, they continue to explore new methods and arguments for collecting sales tax from remote sellers.

One means of doing so is by joining the Streamlined Sales Tax Project. In joining the Streamlined Sales and Use Tax Agreement, a state agrees to take steps toward simplifying and modernizing its sales and use tax administration in an effort to reduce the burden of sales and use tax compliance. The streamlined effort, through uniform definitions and rules, enables vendors to more easily collect and remit sales and use tax. Though the goals of the SSTP are laudable, it is arguable how successful it has been in practice. The SSTP relies on voluntary compliance or the passage of federal legislation. Also, the SSTP has failed to persuade several large sales tax states to join the agreement.

As a more immediate measure, some states, such as New York, have enacted vendor presumption laws (or “Amazon” laws) that broaden the definition of vendor to include some remote sellers. For example, New York broadened the definition of vendor in N.Y. Tax Law sec. 1101(b)(8) to provide that persons making sales of property or services are “presumed to be soliciting business through an independent contractor or other representatives if the seller enters into an agreement with a resident of that state under which the resident” is paid a commission or other consideration for referring customers to the seller. That definition essentially requires vendors that use an affiliate marketing program to collect sales tax. Affiliate marketing is an Internet-based marketing tool that rewards “affiliates” — individuals who maintain a link on their Web site — for sending customers to the vendor’s Web site.

Although the SSTP and vendor presumption have one thing in common — they both are an attempt to get out-of-state retailers to collect and remit sales tax on remote sales — they are otherwise strikingly different. This article will examine the fundamentals behind both the SSTP and vendor presumption laws and evaluate the benefits and shortcomings of each. It will become clear why the SSTP presents a better solution, with one major problem: Will a

¹Those numbers exclude spending on travel, digital downloads, and tickets.

streamlined system ever become the rule nationwide, or will we forever be stuck with a patchwork of sales and use tax laws?

Streamlined Sales Tax Project

The Streamlined Sales Tax Governing Board specifies on its Web site that its goal is “to assist states as they administer a simpler and more uniform sales and use tax system.”² To accomplish that goal, the streamlined effort has attempted to simplify and modernize sales and use tax administration in order to reduce the burdens of compliance. The effort has focused on such concepts as:

- uniformity in state and local tax bases;
- uniformity of tax base definitions;
- simplification of tax rates;
- uniform sourcing rules;
- simplified administration of exemptions;
- simplified tax returns; and
- a central, electronic registration system.

The SSTP began in 1999 because the National Conference of State Legislatures and the National Governors Association were concerned about the potential revenue loss states were facing because they could not, under the U.S. Constitution’s commerce clause, require remote sellers with no physical presence in the state to collect and remit sales tax. Today, 23 states have adopted the simplification measures in SSUTA. Yet even with nearly half of the states as members, “there is some frustration on the part of member states, and likely the board, that some of the larger sales tax states have not signed on to the agreement,” said Loren Chumley, a principal in the State and Local Tax Practice at KPMG LLP and former Tennessee commissioner of revenue. California, Florida, and New York have declined to join the streamlined effort. Getting larger states such as those as members may be one of the biggest challenges the board faces, said Ferdinand Hogroian, a director with PricewaterhouseCoopers LLP.

The problem with getting the larger states to become members, Chumley said, “is that some states find it difficult, politically, to make the law changes necessary to adopt the agreement.” For example, the agreement requires states to adopt uniform definitions, a uniform sourcing rule, and changes to rate and base structures. Sourcing, in particular, has been a sticking point for some states, said Chumley. The agreement uses a destination sourcing rule, which specifies that sales tax is applied at the point where the purchaser takes possession of the goods. A change in sourcing rules can result in a shifting of revenue from one jurisdiction to another. For many states, the loss in revenue from a change to destination sourcing is negligible, but for

other states, such as New York, the loss is significant. The board adopted an alternative sourcing rule to make the transition easier for some states, but the changes may still prove to be a significant burden.

Nonetheless, the streamlined effort is a positive step for member states and for vendors. Chumley said that the streamlined project has successfully established a uniform exemption certificate and a simplified electronic return and made other administration efforts that reduce compliance burdens. Also, the SSTP removed the burden of due care on resale certificates for sellers, which is a strong benefit for vendors. Yet another benefit of the streamlined effort is that if a federal streamlined bill were to be enacted, “nexus would be the same for all states, not just a few who want to demand revenue from out-of-state companies,” said Melanie Little, owner of The Sales Tax Connection in Harrisburg, Pa.

Federal legislation has been introduced several times to implement a streamlined system. In 2009 U.S. Rep. William D. Delahunt, D-Mass., and U.S. Sen. Michael B. Enzi, R-Wyo., introduced the Sales Tax Fairness and Simplification Act of 2009 (H.R. 3393/S. 34). Although its sponsors say the bill would “provide tens of billions of dollars in funding to many state and local governments at a minimal or no cost to the federal government,” its passage is uncertain. Congress has historically been reluctant to address state revenue issues, preferring instead to leave tax administration to the states. As a result, similar bills have gained little to no momentum. Whether this one will suffer the same fate is yet to be seen.

The streamlined effort is, of course, not without its shortcomings. Some practitioners have argued that the SSTP has failed to hold true to its fundamental goals and instead is willing to adjust those goals to accommodate difficult-to-persuade states. Also, the board is still working on how audits will be handled, Chumley said. Finally, the effort has faced, and will continue to face, technical challenges. In particular, Chumley said:

There must be uniform interpretation of the provisions of the streamlined agreement. If states disagree among themselves on how uniform definitions or uniform sourcing rules should be interpreted, the streamlined effort would be undermined.

Vendor Presumption

Vendor presumption laws are an attempt by states to require remote sellers to collect sales tax. However, vendor presumption laws have several major shortcomings, including their questionable constitutionality. Under the U.S. Supreme Court’s decision in *Quill Corp. v. North Dakota*, an out-of-state retailer must have substantial nexus with the taxing state before the state can require the retailer

²See <http://www.streamlinedsalestax.org/>.

to collect and remit sales and use tax.³ Substantial nexus, the Court also held, requires physical presence. Out-of-state remote sellers seem to fall outside the definition of substantial nexus because, by their nature, they have no physical presence in the taxing state.

New York and other states that have enacted or are considering a vendor presumption law argue that if a remote seller has an affiliate marketing or similar program, a seller's in-state affiliates can satisfy *Quill's* physical presence requirements and thus create sales tax nexus for the seller. That argument is based on the theory of attributional or affiliate nexus and has been analyzed in many articles. For purposes of vendor presumption laws, attributional nexus, as established in *Scripto Inc. v. Carson* and *Tyler Pipe v. Washington Dep't of Revenue*, generally holds that if a retailer has in-state agents (though an agency relationship is not required) that sell on behalf of the retailer, the in-state agents may establish nexus on behalf of the out-of-state retailer.⁴

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Even though attributional nexus seems to be applicable to an affiliate marketing program, the e-commerce model and an affiliate marketing program were not contemplated when *Scripto* and *Tyler Pipe* were handed down, and they differ significantly from the fact patterns in those cases. Also, the work of an affiliate is a far stretch from the work of a salesperson "actively engaged" on behalf of *Scripto Inc.* or independent contractors that were calling on customers and maintaining "long-established and valuable relationships" on behalf of *Tyler Pipe*. Most affiliates that participate in an affiliate marketing program do so only part time. Their work is also passive in nature. That is, affiliates do not call on customers, directly solicit orders, or establish long-term customer relationships.

Although the New York Supreme Court of New York County has upheld the state's vendor presumption law, there is no guarantee that a higher court in New York or a court in another jurisdiction will

follow suit.⁵ A more thorough commerce clause analysis than that provided by the New York court would dictate a ruling striking down New York's law. Two of the major shortcomings of that type of law are that the constitutionality of vendor presumption is questionable and e-commerce retailers believe the laws are unfair because they capture only some remote sellers. Vendor presumption laws may raise some revenue for states in the short term, but in the long term, they require potentially unconstitutional sales tax collection, present a remedy problem if the laws are struck down, and do nothing to encourage more widespread voluntary compliance from remote sellers.

Streamlined Versus Vendor Presumption

Although the streamlined effort and vendor presumption share a common thread — both are attempts to force remote sellers to collect sales tax — they are fundamentally different. Chumley said:

The SSTP and vendor presumption are going along very different paths. Vendor presumption, by itself, has not yet addressed the issues left after the *Quill* decision. Good tax policy would dictate that a state should make it as easy as possible to comply. Currently, vendor presumption is challenging for companies from a compliance standpoint.

Vendor presumption is a limited yet forceful remedy to a difficult problem. What it fails to do is address why the problem exists in the first place. The *Quill* opinion was issued more than 17 years ago. E-commerce and its potential issues for sales tax collection were not considered by the Supreme Court justices. The justices were concerned with the burden of requiring vendors to collect sales tax in thousands of jurisdictions in which the vendors had no physical presence. The potential burden that sales tax collection places on remote vendors has not diminished, and the concern over that burden should not diminish. Yet drafters of vendor presumption laws chose to ignore it.

By contrast, if states are able to join the SSTP, which could create a more uniform system that could encourage broad-based compliance by remote sellers, it seems beneficial to do so. Hogroian said that "the streamlined effort, if successful, could result in a simplified system and harmonized laws among all states, while vendor presumption provides none of these benefits in addressing nexus on a state-by-state basis." Also, vendor presumption is a piecemeal approach aimed at specific remote

³504 U.S. 298 (1992).

⁴*Scripto*, 362 U.S. 207 (1960); *Tyler Pipe*, 483 U.S. 232 (1987).

⁵*Amazon.com LLC v. New York State Dep't of Taxation and Finance*, No. 60127/08, New York Supreme Court of New York County (opinion filed Jan. 12, 2009). (For the decision, see *Doc 2009-641* or *2009 STT 8-16*.)

sellers, while the ultimate goal of the streamlined effort is to apply a uniform nexus standard to all sellers, Hogroian said.

Dueling Efforts?

For states that are in a revenue crisis, vendor presumption has one significant advantage — the immediate revenue gain that comes from requiring some remote vendors to collect sales tax. SSTP, by contrast, depends on voluntary compliance or federal legislation. That said, there is little doubt that in enacting vendor presumption laws, states are frustrating the goal of the streamlined effort. “If there is no broad application of the streamlined approach,” said Hogroian, “there cannot be a streamlined system.”

Little likewise said that vendor presumption laws are “completely ignoring any hope the SSTP presents. Instead of joining the streamlined effort and utilizing volunteer organizations to collect their sales taxes, states that have or are planning to enact vendor presumption laws are trying to strong-arm their way to gain compliance in a bully-like manner.”

Besides potentially upsetting efforts to create a simplified, uniform system, vendor presumption could hinder the streamlined effort in other ways. Because some streamlined states, such as North Carolina and Rhode Island, have enacted vendor presumption, those states may believe it is less important to maintain streamlined compliance. Adopting vendor presumption and lessening compliance with SSUTA may give Congress the impression that vendor presumption is a viable remedy for states concerned with collecting sales tax from remote vendors. Any indication that a remedy is available to states, and in particular that some states have already adopted that remedy, will diminish the urgency of streamlined legislation, Hogroian predicted.

Solutions Available

One of the main issues with requiring retailers to collect and remit sales tax nationwide is compliance. There are some 8,000 taxing jurisdictions in the United States. Even if basic rates could be determined and updated regularly, other problems further complicate matters. Determining how to handle tax-exempt sales, sales tax holidays, and product taxability coding can be a daunting task, particularly for small and midsize businesses. It has been estimated that sales tax exemptions account for 60 percent of the cost of compliance for small businesses. Eliminating some of those exceptions could significantly reduce the compliance burden.

However, the challenge of determining what sales tax rate should apply can be addressed, particularly if there is nationwide adoption of the agreement with its uniform definitions and tax bases, which would simplify the system. What is needed is for technology providers to create viable (and afford-

able) solutions for vendors. Although that is already happening, market forces dictate that if a streamlined solution is adopted and remote vendors are required to collect sales tax, technology providers will create solutions to meet unmet needs. However, any streamlined solution should avoid broadening a small-business exception. Raising such a threshold would neither promote improved technology nor encourage small businesses to grow.

Vendor presumption is a piecemeal approach aimed at particular remote sellers, while the ultimate goal of the streamlined effort is to apply a uniform nexus standard to all sellers, Hogroian said.

Several businesses already provide technology for sales tax compliance. AccurateTax.com is one such company. Its owner, Pete Petracco, explained that the company evolved from its predecessor, Miva Merchant, to address the issue of destination-based sales tax collection. Vendors needed a ZIP-code-based system with more frequent updates. AccurateTax.com offers that. It is a thin client system in which a vendor’s retail software calls the AccurateTax.com servers to verify sales tax information for each purchase. The system will soon account even for sales tax holidays.

There are other technological solutions available to vendors. The governing board has certified several that use various methods. Some systems will impose a flat sales tax rate and reconcile with the vendor quarterly. In any case, technology solutions exist or will exist and should be encouraged. But they will work best with a system that is as simple and uniform as possible. The more exceptions and rates that must be included increase the potential for errors or noncompliance.

Conclusion

It’s not news that economic times are tough. States are looking for new and creative ways to generate revenue — and will continue to do so for the foreseeable future. Because of the rise of e-commerce retailers, and the near guarantee that e-commerce will continue to grow, the problem of how to capture sales tax on remote sales will remain. It is important for states to realize that a strong-arm approach such as vendor presumption does nothing to address the larger issues concomitant with sales taxation and e-commerce. And what is worse, vendor presumption may act as an impediment to the streamlined effort at both the state and federal levels, blocking an attempt to offer real solutions to the problems facing states and remote sellers. ☆