

From the Experts: Taxation of Internet Sellers

A look at pending federal legislation.

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As a practical matter, many purchases made on the Internet are tax-free. But Congress is now being asked to change that.

Internet-based sellers cannot currently be forced to collect sales or use tax in a state unless they have a physical presence in the state, due to a 1992 United States Supreme Court decision; in reliance on the decision, many Internet sellers do not collect sales or use tax in states in which they lack a physical presence.

Technically, tax should still be paid. Consumers of taxable goods (including businesses that do not resell what is purchased) should pay a complementary use tax directly to the state government, if the seller is not collecting the tax. However, as a matter of reality, consumers (except for larger businesses) rarely pay use tax when purchasing items from Internet sellers. It is not generally cost-effective for state tax departments to audit individuals to ensure that use tax is being paid on Internet purchases. Therefore, as a practical matter, Internet purchases often escape sales and use tax.

The easiest “fix” would be to require Internet sellers to collect the tax. However, the 1992 Supreme Court decision prevents states from enacting legislation that would require Internet sellers to collect tax. Other than the Supreme Court reversing itself, the only way to require Internet sellers to collect tax is by enacting federal legislation that would legislatively override the 1992 Supreme Court decision.

To this end, several bills have recently been introduced in Congress. The bills would require remote sellers (including Internet retailers) to collect sales or use tax, but the bills would have a dramatically different effect depending on whether a state has adopted the Streamlined Sales and Use Tax Agreement, a pact that 21 states have signed as full members and that is designed to provide uniform sales and use tax definitions and rules that apply across member states. Additionally, the bills impose different simplification requirements on states that enact legislation requiring remote sellers to collect sales and use tax.

One of those bills, the Main Street Fairness Act applies only in states that have adopted the Streamlined Sales and Use Tax Agreement. Under the bill, “streamlined states” may require remote sellers to collect sales or use tax, and in exchange the states must maintain certain

simplification measures and hold a seller harmless for tax collection errors, if the seller relies on software certified by the state or on information provided by the state. Additionally, the states must provide reasonable compensation to sellers for compliance costs. The federal Court of Claims would have jurisdiction to hear disputes arising under the Main Street Fairness Act.

A second bill, the Marketplace Equity Act, applies in all states, not just states that have adopted the Streamlined Sales and Use Tax Agreement. It provides that a state can require remote sellers (including Internet sellers) to collect sales and use tax so long as certain simplification requirements are met. In particular, states must provide: (1) an exception for “small sellers” that have less than \$1,000,000 in remote sales nationally or less than \$100,000 in remote sales sourced to the state; (2) one of several tax rate structures; and (3) a single tax form that can be used for all sales made in the state. The Streamlined Sales and Use Tax Agreement is irrelevant under this bill.

A third bill, the Marketplace Fairness Act, provides two regimes, one for streamlined states and one for non-streamlined states. Streamlined states are authorized to require remote sellers (other than small sellers) to collect sales and use tax. Non-streamlined states are authorized to require remote sellers to collect sales and use tax so long as certain simplification requirements are complied with, including that a state must provide: (1) a single state-level agency that administers sales and use tax laws; (2) a single sales and use tax return; (3) a uniform sales and use tax base among the taxing jurisdictions within the state; (4) a destination rate tax rate; (5) adequate software that identifies the applicable destination rate; and (6) relief from liability for relying on information supplied by the state.

The bill also contains a small seller exception under which the states cannot tax any non-physically present seller that has less than \$500,000 in annual total remote sales. A major distinction between this bill and the other two bills is that the Streamlined Agreement can be amended to be a total nullity (by removing all simplification requirements) yet states that are “streamlined” members could still require remote sellers to collect.

Will any of these bills be passed? It is far too early to tell. With electronic commerce booming and the states continuing to lose revenue on Internet sales, the issue is increasingly in the spotlight. Businesses that would be significantly impacted by these bills should be monitoring them, along with other legislative activity in this area, and should consider offering public feedback and comment on the bills, as the bills remain very much works in progress and are subject to change.

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