

TO TAX OR NOT TO TAX E-COMMERCE: A UNITED STATES PERSPECTIVE

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ABSTRACT

Within the United States, state and local governments have been struggling, and continue to struggle with the significant challenges e-commerce presents to systems of taxation. This paper first discusses sales and use taxes within the United States. Second, trends contributing to the increasing complexity of e-commerce taxation are identified. Third, the viewpoints of opponents and proponents of taxation are presented. Fourth, the constitutional considerations of requiring remote, i.e., out of state vendors, to collect and remit state and local sales and use taxes are discussed. Finally, the recommended solution of the Streamlined Sales Tax Project (SSTP), resulting in the Streamlined Sales Tax Agreement (SSTA) and pending federal Streamlined Sales and Use Tax Act (SSUTA), is analyzed.

Keywords: E-Commerce taxation, Internet taxation, Consumption tax, Sales tax, Use tax

1. Introduction

E-commerce is changing the nature of the marketplace. At the end of the 20th century, an information-based economy emerged, with the provision of services representing over one-half of all economic activity in industrialized nations. E-commerce represents a significant source of business revenue. North American companies reported 33% of domestic revenue was derived from e-commerce transactions, 30% for Pacific Rim companies, 25% for European companies, and 22% for South American companies [Rendleman 2001]. Taxation of e-commerce transactions could provide significant revenue for national and local governments. For example, an estimated US\$13.3 billion in sales and use taxes¹ could have been collected in 2001 in the United States [Bruce and Fox 2001]. As business to business (B2B) e-commerce continues to increase, this uncollected revenue is projected to rise to US\$45.2 billion by 2006 and US\$54.8 billion in 2011, resulting in a cumulative decade loss of US\$439 billion between 2001 and 2011. The Direct Marketing Association (DMA) however contends these estimates are based on overstated projections of the size of future e-commerce sales and understated voluntary payment of sales and use taxes by businesses. The DMA estimates the lost revenues in 2001 were \$1.9 billion and projects \$4.5 billion in lost revenue by 2011 [Jossi 2003].

Within the United States, state and local taxation rules developed to address local property ownership, receipt of income, the sale of tangible property, and locally or regionally based commerce. This historical development is evident in the tax base reliance on property taxes, on tangible or real property, transactional taxes, and income taxes, primarily. It is certainly easier to tax locally based business activity than it is to tax mobile or multi-jurisdictional business activity, that is, sales subject to taxation by more than one government entity such as cities, counties, and states. This is especially true for transactions involving intangible property, and digital goods and services. Indeed, it is argued that e-commerce threatens to undermine state and local taxation, especially the collection of sales and use taxes.

National, state, and local governments have been, and continue to struggle with the significant challenges e-commerce presents to systems of taxation. The scope of e-commerce taxation is very broad, extending to issues

1. The nature of state sales and use taxes is discussed in section 4.

such as income taxation, sales and use taxes, value-added taxes, internet access, and other telecommunications taxes and fees. The scope of this paper is the taxation of e-commerce which occurs within the United States. A consideration of the impact of sales by offshore vendors, a complex issue, is not addressed. It is the objective of this paper to demonstrate the need for a national solution to the issue of e-commerce taxation within the United States through federal legislation. First, the paper discusses sales and use taxes within the United States. Second, trends contributing to the increasing complexity of e-commerce taxation are identified. Third, the viewpoints of opponents and proponents of taxation are presented. Fourth, the constitutional considerations of requiring remote, i.e., out of state vendors, to collect and remit state and local sales and use taxes are discussed. Finally, the recommended solution of the Streamlined Sales Tax Project (SSTP), resulting in the Streamlined Sales Tax Agreement (SSTA) and pending federal Streamlined Sales and Use Tax Act (SSUTA), is analyzed.

2. Sales and Use Taxes Within the United States

Although founded on European political philosophy, the governmental structure of the United States functions somewhat differently than most European states. This difference is in the origin of the nation. After Britain granted independence to the 13 colonies, the 13 independent sovereigns were left with the task of forming a union. At first, the new nation tried to function as a very loose union under the Articles of Confederation. When this failed, state representatives drafted, and the states ratified, the United States Constitution. The Constitution was, in part, a compromise between national and state sovereignty, and the distribution of power between larger and smaller states. As part of this compromise, the "Commerce Clause" contained Article 1, Section 8 of the Constitution granted the federal government broad powers with respect to interstate commerce. Through judicial interpretation, this federal power was broadened further, and states were restricted in the burdens that they could impose on interstate commerce. Thus, the taxation of interstate e-commerce by state and local governments is subject to constitutional limitations and review by federal courts.

Within the United States, most states rely, in part, on transaction and consumption based taxes as part of their overall state taxation system. The only states that do not have sales taxes are Alaska, Delaware, Montana, New Hampshire, and Oregon. Cities, other municipalities, and counties may also have such taxes. These sales and use taxes are products of an industrial age consumption model that was locally based. Taxable goods and services that are purchased within the state are subject to a sales tax which is collected, reported, and remitted to the state by the vendor. Out of state taxable purchases, brought back into the state, are subject to a use tax payable by the in-state purchaser. A use tax is simply a substitute for a sales tax. It is a tax on the use of an item, within the taxing state, by a resident, when the item was purchased out of state. This tax is applicable only when no equivalent amount of sales tax has been paid in the state of purchase. If a sales tax was paid in the state of purchase, the amount paid is credited against the use tax liability. Thus, the issue is most acute when the remote vendor is domiciled in a state without a sales tax. For example, if a Pennsylvania resident purchased a US\$20,000 automobile in Delaware, which has no sales tax, the purchaser would be required to pay a US\$1,200 (6%) use tax to Pennsylvania before registering the vehicle. This is the same amount of tax that the purchaser would have paid as a sales tax had the purchase been made in-state. The consumer would be taxed either in the state of purchase or in the state of destination, but not both.

2.1. The Collection of Sales and Use Taxes from Consumers

An automobile purchased out of state must be registered and this forces the use tax compliance. Most goods and services do not require licensing or registration. Often, out of state, or remote purchases remain unreported. A purchaser may purchase goods in a non-tax state either physically or by mail order and fail to pay the use tax when he returns to his home state. E-commerce facilitates transactions between purchasers and remote vendors, thus increasing the likelihood of non-payment of state sales and use taxes.

Enforcement and collection of use taxes on out of state purchases is made difficult by a number of factors. First, non-business consumers are often unaware of the obligation to pay a use tax on out of state purchases. Even if the non-business purchaser is aware of the use tax obligation, the tax may not be paid because the purchase transaction and tax payment occur separately, necessitating that non-business consumer to take the initiative to comply. Second, states generally do not have significant enforcement and collection programs for non-business purchasers. Third, states usually rely on the vendors to collect and remit the tax. For the remote vendor however, this responsibility is often perceived as too burdensome. Further, the remote vendor may consider itself without a legal obligation to collect the use tax. The burden on the remote mail order or e-commerce vendor is significant because of the incredible multiplicity of taxing jurisdictions. In addition to 45 states with sales taxes and the District of Columbia, there are approximately 7,500 counties, cities, towns, and special districts that also impose sales and use taxes [U.S. Bureau of Census 1998].

2.2. The Collection of Sales and Use Taxes from Businesses

Enforcement and collection of use taxes is much higher for business purchasers. Businesses tend to recognize use tax compliance as a cost of doing business. As with other business taxes, compliance can be increased by aggressive audit practices by the state. This is usually done in conjunction with an income tax audit. The cost of the item purchased out of state will usually be discoverable as an expense or cost recovery deduction on the business's income tax return. Once the item is discovered the auditor can check to see if the use tax was paid. Non-compliance can result in liability for back taxes, interest, and other penalties.

2.3. Efforts to Reduce the Loss of Sales and Use Tax Revenues

To reduce the loss of tax revenues, some states have increased their efforts to collect use taxes at the consumer, rather than at the remote vendor, level. In 1999 North Carolina, for example, began including the use tax as a line item on its individual income tax returns. The result was US\$4.3 million in use tax collection. This tactic has spread to other states. Some states are trying a collective approach to combat the avoidance and evasion problems. For example, the Southeastern Association of Tax Administrators (SEATA), an association of twelve member states, developed an information exchange agreement whereby member states share information regarding sales to buyers from other member states. In ten years, this agreement has resulted in the collection of US\$69.8 million of otherwise uncollected use tax revenue [Masterson 2000].

2.4. Digital Products and Services Delivered via the Web

Further complicating the sales and use tax issue is the method of product delivery. Traditionally, sales and use tax cases are concerned with purchases from remote mail order vendors where the goods were either received at the vendor's place of business or physically shipped to the purchaser. In these cases, the court considers physical, not digital delivery, of tangible goods or specified services to which state sales and use taxes generally apply. An intriguing question is how do these taxes apply to digital products and services delivered via the web? If shrunk-wrapped software or a music CD is taxable, is the same software or music taxable if it is delivered digitally to the purchaser or by allowing the purchaser access to a server of the vendor? Was the Napster craze only about free online music or something more? The online music phenomenon can be viewed as an issue of choice and convenience, not price [Weber 2001]. Selling and delivering music, books and similar products digitally is a marketing technique. Rather than buying a CD that contains only a few works of interest, digital unbundling would allow the purchaser greater choice, coupled with the convenience of digital purchase, payment, and delivery. However, electronic delivery of digital products and services creates additional state tax issues for e-commerce.

As will be discussed, state efforts to collect sales and use taxes are impeded not only by the costs and difficulties associated with enforcement, but by specific requirements and prohibitions contained within the United States Constitution. The new business models of e-commerce only complicate the state's enforcement and collection efforts. The confusion surrounding the sales and use tax issue is not solely a state concern. Vendors are concerned about potential liability. A remote vendor who refuses to collect and remit this tax is at risk of being held liable for many years' use taxes, plus interest and penalties if it is later determined that the vendor was required to collect and remit.

3. The Complexity of E-Commerce Taxation

The taxation of e-commerce is a complex issue which cuts across city, county and state borders within the United States, national borders, and tax types. The growth of e-commerce raises complex issues associated with the taxation of multi-jurisdictional transactions and the sourcing of sales of, or income from, services or intangible property transactions. As shown in Figure 1, we identify several trends contributing to the complexity of e-commerce taxation, including borderless commerce, digital convergence, virtual organizations, automated transactions, and new business models.

3.1. Borderless Commerce

E-commerce is borderless, with transactions flowing seamlessly across the globe. The taxation of cross-border transactions is one of the most challenging areas of taxation. Within the United States, the additional burden of tax compliance is an economic, political, and constitutional issue. The constitutional issues are discussed in section 5.

Remote vendors selling directly to customers in other jurisdictions without wholesale distributors or retail outlets, referred to as disintermediation, may encounter the necessity to contend with tax requirements in numerous additional jurisdictions for the first time. The continued growth in borderless commerce will lead to a corresponding increase in both business tax compliance efforts in multiple jurisdictions and jurisdictional disputes over which jurisdiction can impose taxes. For example, in the European Union, European based e-commerce companies are required to pay a nationally levied sales tax on internet sales [Hofheinz and Simpson 2002]. However, United States counterparts are not required to do the same, resulting in a competitive price advantage. This imbalance has now shifted with the European Union's new tax on downloadable goods. European Union companies pay taxes based on where the seller is based, while non-European companies pay based on where the buyer lives. A United States

software industry lobbyist contends “an element of discrimination” in this tax because European Union consumers from countries with high taxes will gravitate toward European Union sellers in countries with low taxes and away from companies outside the European Union [Hofheinz and Simpson 2002].

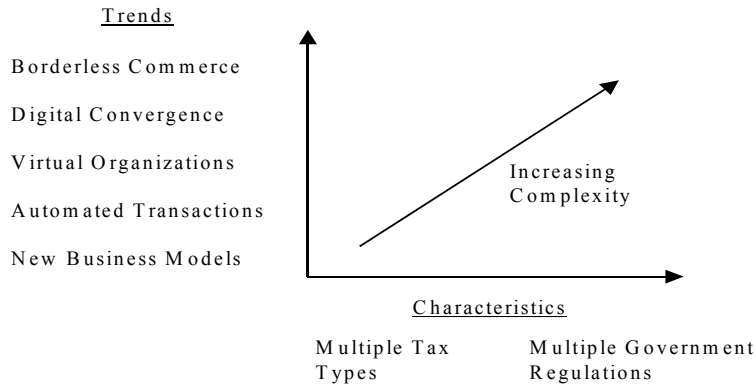


Figure 1. The Increasing Complexity of Global E-Commerce Taxation

3.2. Digital Convergence

Over time, technological innovations have been incorporated into commercial activities, changing the products and services themselves, their delivery, and how processes underlying the completion of a transaction are performed. Digital communications have produced an integrated digital platform. As shown in Table 1, there is a wide array of products and services offered in digital format that are both purchased and delivered through this digital connectivity. The taxation of such services and intangibles raises complex tax issues. Current tax rules may simply be inapplicable to these digital products and services.

3.3. Virtual Organizations

E-commerce has contributed to the ease with which companies can enter into joint ventures, partnerships, outsourcing agreements, and other arrangements, transforming them into virtual organizations. For example, at Cisco Systems, a leader in networking solutions for the internet, over two-thirds of manufacturing is outsourced to other companies and over three-quarters of sales occur on-line. Such an agile virtual enterprise would find relocation of property and payroll functions to jurisdictions with more favorable income tax rates and rules to be relatively easy. The emergence of virtual organizations will put pressure on taxing authorities to develop new rules for apportioning the income of these more mobile and dynamic businesses.

Table 1. The Diversity of Digital Products and Services

Books	Magazines
Bulletin boards and chat rooms	Movies
Business databases	Music
Educational and training materials	Newspapers
Electronic bill payments	Photography
E-mail	Remote medical diagnosis
Financial transactions	Remote repairs
Games	Software
Gift certificates	Stock trading
Home banking	Telecommunications
Information services	Videoconferencing
Internet access services	

3.4. Automated Transactions

Since e-commerce entails automation of business transactions, a natural extension is to include the automation of transactional tax collection and payment compliance capabilities. Each of the 7,500 sales and use tax jurisdictions within the United States has its own listing of taxable items, exemptions, and rates. Constitutional issues aside, this multiplicity and diversity of taxing jurisdictions arguably makes tax compliance by the remote e-commerce vendor

unduly burdensome. Governmental development of a simplified national system would reduce the burden borne by remote vendors in discharging tax compliance obligations. This, and the related issue of vendor liability for non-compliance, will be addressed in the discussion of the Streamlined Sales Tax Agreement.

3.5. New Business Models

New business models have emerged based on the integration of technological characteristics of e-commerce into business processes. On-line auctions, reverse auctions, virtual communities, infomediaries, aggregators, and brokers all represent new ways of doing business. Traditional businesses have also undergone changes. Manufacturers and wholesalers, for example, have extended their sales function into retailing. These new business models pose challenging tax issues. For example, gift certificates, traditionally purchased directly at a retail outlet, can now be purchased at Giftcertificates.com. Gift certificates are purchased from various retail establishments at a discount and then are resold over the web. This new business model raises new taxation issues such as the identity of the actual retailer, the sourcing of consumption, the classification of the good or service sold, and the relevant sales price upon which the transactional tax would be based. New tax rules incorporating these new business models must also allow adaptability to future business models which emerge.

4. To Tax or Not to Tax E-Commerce

A temporary moratorium on new state and local internet access taxes and fees was mandated by the Internet tax Freedom Act of 1998. This moratorium was extended to November 1, 2003, by the Internet Tax Freedom Act of 2001. The currently pending Internet Tax Non Discrimination Act, introduced in the United States Congress (comprised of the House of Representatives and the Senate) in 2003, seeks to make the moratorium permanent and repeal any existing state and local access taxes and fees by 2006. This Act was passed by the House of Representatives on September 17, 2003 and is currently listed on the Senate Legislative Calendar. The Senate has not yet brought this Act to a vote. Some erroneously assume that these acts also protect e-commerce transactions from state and local sales and use taxes. This is a completely false assumption.

The broader issue of the taxation of access to the internet is often confused with the issue of the taxation of e-commerce. The proponents of a tax free internet argue that internet access taxes and fees result in rate hikes making access more expensive for the consumer and thus restricting the growth of internet use and e-commerce. Further, these proponents argue against imposing the requirement to collect and remit transactional taxes on remote e-commerce vendors because of the cost of compliance with multiple taxing jurisdictions. Such cost is viewed as a barrier to market entry for small, start up e-businesses.

Proponents of internet taxation focus on the loss of tax revenue and tax neutrality regardless of the business model, i.e., clicks versus bricks. Non-compliance with the payment of transactional taxes has real revenue implications for governmental entities. For example, the California State Board of Equalization estimates that in 2001 uncollected taxes from mail order and e-commerce sales cost the state and local governments US\$1.2 billion [Hubbard 2003]. Since transactional taxes are a significant revenue source, an increase in non-payment would result either in an increase in other taxes or a contraction of government functions and/or programs. Further, an increase in the ability to avoid or evade transactional taxes could adversely affect the local tax base. What will be the impact on the local tax base and economy of redirecting commerce from local brick and mortar businesses to remote e-commerce businesses because of the perceived tax savings?

5. United States Constitutional Issues

Any scheme of taxation which attempts to tax remote vendors must confront the requirements and prohibitions of the Due Process Clause and the Commerce Clause of the United States Constitution. The requirements of these clauses have at times been considered similar or even the same. The United States Supreme Court decision in *Quill v. North Dakota* [1992], clearly differentiated these constitutional provisions and, in so doing, may have created the opportunity for a United States Congressional solution. Although *Quill* factually deals with a remote mail order vendor, its holdings are equally applicable to a remote e-commerce vendor.

5.1. Due Process Clause of the United States Constitution

The Due Process Clause of the Fourteenth Amendment to the United States Constitution requires that governmental action must be fundamentally fair. This “fundamental fairness” test, when applied to a state’s power to impose on a remote vendor the duty to collect and remit use taxes, has resulted in the United States Supreme Court consistently holding that due process requires some minimum connection between a state and the person, property, or transaction taxed. This holding was reaffirmed for mail order remote vendors in *National Bellas Hess, Inc. v. Department of Revenue of Illinois* [1967]. In *National Bellas Hess*, the remote vendor mailed catalogues and advertising flyers to potential customers in Illinois. Orders were accepted at its Missouri plant. The ordered goods were delivered to the customers by mail or common carrier. The company had neither outlets, sales representatives,

nor other incidents of physical presence. Despite a lack of physical presence, Illinois maintained that National had a duty to collect and remit use taxes on orders from Illinois. The Court held that to impose this obligation on National would violate the Due Process Clause because of the vendor's lack of physical presence within the state of Illinois. The economic benefit that National received from the Illinois market was not considered a sufficient contact. It was held that the remote vendor must have some physical presence in the taxing state.

This issue of the requisite minimum connection required, before a state can constitutionally require a remote vendor to collect and remit use taxes, was later revisited in *Quill*. Quill Corporation was an out of state mail order supplier of office equipment with neither sales agents nor outlets within the state of North Dakota. Its ownership of tangible property in North Dakota was either insignificant or nonexistent. Quill solicited business through catalogues, flyers, advertisements in national periodicals, and telephone calls. It was the sixth largest vendor of office supplies in the state selling to about 3,000 customers. All deliveries to Quill's North Dakota customers were made by mail or common carrier from out of state locations. North Dakota sought to impose the duty on Quill to collect and remit use taxes based upon its statutory definition of retailer. These facts seem very similar to *National Bellas Hess* and to many remote vendor e-commerce transactions.

Although the facts of *Quill* are very similar to *National Bellas Hess*, the Court used this case to refine its due process analysis in light of changing technologies and economics. The Court reaffirmed that due process requires some definite link or minimum contact between the state and the person, property, or transaction it seeks to tax. However, the Court noted that the test of jurisdictional due process, i.e., the state's power to subject an individual or entity to its judicial power, had evolved since *National Bellas Hess*. In *Burger King v. Rudzewicz*, the Court noted that business can be transacted primarily by mail and wire communications across state lines and held that "so long as a commercial actor's efforts are 'purposefully directed' toward residents of another State, we have consistently rejected the notion that an absence of physical contacts can defeat personal jurisdiction there" [*Burger King* 1985]. The Court then held that purposefully taking advantage of the benefits of a state's economic market satisfied the due process requirements for purposes of jurisdiction, without physical presence in the state. In *Quill*, the Court used analogous reasoning to establish a due process "purposefully directed" test for imposing the duty to collect and remit use taxes on a remote vendor. Quill had "purposefully directed its mail order activities at North Dakota residents, [that] the magnitude of those contacts is more than sufficient for due process purposes, and the use tax is related to the benefits Quill receives from access to the State" [*Quill* 1992]. Thus it seems that, based on *Quill*, a remote e-commerce vendor, with more than a minimal business presence in a host state, will not be able to avoid the obligation to pay and remit use taxes based upon a lack of physical presence. However, Due Process is not the only constitutional hurdle presented by the sales and use tax issue.

5.2. Commerce Clause of the United States Constitution

Even if a state's statute requiring a remote vendor to collect and remit use taxes satisfies the requirements of the Due Process Clause, the remote vendor is still subject to the limitations of a state's power to tax or otherwise burden interstate commerce imposed by the Commerce Clause. Although, a state may, consistent with due process, have the power to tax a remote vendor, the imposition and collection of the tax may still violate the limitations of the Commerce Clause. These constitutional provisions are related, but different. For use taxes, due process requires some minimum connection between the taxpayer and the taxing state, while the Commerce Clause is concerned with the effect of the imposition of the tax on interstate commerce. The use tax analysis focuses on the issue of whether subjecting the remote vendor to taxation in multiple jurisdictions creates an impermissible undue burden on interstate commerce.

Although the Court, in *Quill*, found that the minimum contacts requirement of Due Process was satisfied without physical presence, it clearly stated that minimum contacts do not of themselves satisfy the requirements of the Commerce Clause. For states, the Commerce Clause prohibits both discrimination against interstate commerce and state actions that unduly burden interstate commerce. The Court reaffirmed the four part test of *Complete Auto Body v. Brady* [1977]. Under *Complete Auto's* test, a tax will survive a Commerce Clause challenge if the "tax [1] is applied to an activity with a substantial nexus (physical presence) with the taxing state, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the state."

Applying this analysis to the facts of the *Quill* case, the Court expressly rejected North Dakota's "slightest presence" argument that bare title to a small amount of leased software within the state satisfied the substantial nexus, i.e., substantial connection, requirement of the Commerce Clause. Thus, even though Quill's purposeful actions directed towards North Dakota's residents were a sufficient minimum contact for due process purposes, these actions do not satisfy the substantial nexus requirement of the Commerce Clause.

5.3. Due Process and Commerce Clauses Applied to E-Commerce

As mail order and e-commerce operations have expanded, states have continued to try to collect use taxes from remote vendors through both legislation and court action. Subsequent to *Quill*, the Court of Appeals of New York

and the Illinois Supreme Court seem to have attempted to lessen the physical nexus requirement by substituting a more than slightest presence test [*Orvis* 1996]. However, other courts have strictly adhered to *Quill's* physical nexus requirement. In *America Online, Inc. v. Johnson* [2001], the Tennessee Chancery Court refused to find substantial nexus without a substantial physical presence. America Online (AOL) had done substantial business with its Tennessee customers and the state wanted to impose and collect over US\$9 million in sales and use taxes for the period December 1, 1990 to June 30, 1997. This state court strictly followed *Quill*, even though AOL had substantial economic, if not physical presence. The Tennessee Court of Appeals reversed and remanded the case back to the Chancery Court suggesting that a substantial nexus satisfying the Commerce Clause might be established by activities carried on within the state by AOL's affiliates and independent contractors [*America Online, Inc.* 2002].

Does case law signal the possibility that because of its different business model, e-commerce will be able to use the Commerce Clause in reverse, i.e., to in effect cause state taxation to be discriminatory against, and put a discriminatory burden on, local commerce? The *Quill* Court seemed concerned with this possibility and made note that while the United States Congress, without a constitutional amendment, could not cure a due process defect, the almost plenary power of Congress to regulate interstate commerce gave it the ultimate power to resolve the substantial nexus issue of the Commerce Clause. Since the "purposely directed" due process test of *Quill* should not be a difficult standard for a state to meet, the United States Congress should focus on the policy issues surrounding the substantial nexus requirement.

6. United States Congressional Action or Inaction

The United States Supreme Court invited Congress to resolve the Commerce Clause issue for remote vendors in its 1992 *Quill* decision. A decade later, there has been much discussion, some progress, but no resolution. This issue has been caught up in the original Commerce Clause concern over discriminatory state taxes and the burden of compliance with multiple jurisdictions. This issue has also been significantly impacted by a continuing political disagreement that goes back to the formation of the nation, i.e., the size of government and the level of taxation.

6.1. Internet Tax Freedom Act

Although the broader issue is the obligation of remote vendors, both mail order and e-commerce, to collect and remit sales and use taxes, the United States Congress has also focused on the broad issue of state taxation of the internet. In 1998 the Internet Tax Freedom Act (ITFA) became law. This Act is intended to help economic growth by preventing fledgling e-businesses from being burdened with new taxes and tax compliance, and to create a moratorium on new taxes. *The ITFA does not, as is popularly believed, exempt e-commerce from taxation.*

The ITFA seeks to protect the development of the internet and e-commerce, and the free flow of information through the following provisions:

1. A three year moratorium on the taxation of internet access, prohibiting state and local governments from taxing internet access charges.
2. A three year moratorium on multiple and discriminatory taxes on e-commerce. State or local governments are prohibited from imposing taxes on buyers and/or sellers in multiple jurisdictions. The application of discriminatory tax collection requirements on out of state e-businesses through an expanded definition of nexus is prohibited.
3. Establishes the Advisory Commission on Electronic Commerce (ACEC) to study the issues relevant to the taxation of e-commerce and report back to the United States Congress.
4. Declares the Internet to be a tariff free zone and encourages collaboration with the EU and WTO to keep e-commerce free from tariffs and discriminatory taxes.
5. Provides no new federal taxes on e-commerce.

The provisions of the ITFA were extended by Congress in 2001. This extension expired on November 1, 2003. As previously mentioned, an act to make the ITFA provisions permanent and repeal existing state access taxes and fees by 2006, the Internet Tax Non Discrimination Act, is currently pending before Congress.

6.2. Streamlined Sales Tax Project

The recommendation of the Advisory Commission on Electronic Commerce (ACEC), created by the ITFA, was a five year extension of the moratorium. At the same time, other groups combined to develop a proposal that attempted to balance the interests of both e-business and state and local government. The resulting proposal, the Streamlined Sales Tax System (SSTS), was studied by various groups, including the United States Congress. The SSTS attempts to provide a system for state governments and business that simplifies and modernizes the collection and remission of sales and use taxes. The product of this work is the Streamlined Sales Tax Agreement (SSTA). States are not required to approve the SSTA, but 37, of the 45 states with sales taxes, have approved the Agreement.

Section 102 of the SSTA states that its purpose “is to simplify and modernize sales and use tax administration in the member states in order to substantially reduce the burden of tax compliance.” In other words, the purpose is to provide a tax system that Congress will accept as not unduly burdening interstate commerce. Congress, through its Commerce Clause powers, would then be able to enact legislation permitting member states to collect sales and use taxes from remote vendors following the tax system contained in the SSTA. Non-member states would still be confronted with the substantial nexus requirement of *Quill*.

In summary, the SSTA provides the following:

1. Participating states will use common definitions in their tax base. However, each state legislature would ultimately determine the taxability of an item in their respective state.
2. Sales and use tax collection will be administered on the state, not local level. The states shall then distribute taxes to the appropriate local government, thereby lessening the administrative burden on remote vendors.
3. States will be required to use a single sales and use tax rate for most personal property and services, although a second rate will be permissible for food, food ingredients, and drugs.
4. Local jurisdictions which levy a sales and use tax must share a common tax base with the state by January 1, 2006.
5. States will employ uniform sourcing rules for all taxable transactions. These rules will be destination based, that is, sales will be taxable in the state of the purchaser.
6. Sellers will be required to file only one tax return for each tax period for each participating state.

It should be re-emphasized that state participation in the Agreement is voluntary. If a state chooses to participate, it will need to make the necessary statutory changes to comply with the provisions of the Agreement.

6.3. Streamlined Sales and Use Tax Act

With respect to the SSTA and the obligation of remote vendors to collect and remit sales and use taxes, Congress has been considering the Streamlined Sales and Use Tax Act (SSUTA), introduced in 2003. If enacted, Congress will have determined that the SSUTA provides sufficient simplification and uniformity to warrant Congressional authorization to states, that are parties to the SSTA, to require remote sellers to collect and remit the sales and use taxes of participating states and their local taxing jurisdictions. This is the type of Congressional action that the Supreme Court alluded to in *Quill*.

If enacted the SSUTA delegates to the states the issues and cost of implementation. The act provides that once 10 states, comprising at least 20 percent of the total population of the United States, petition for membership under the SSTA any Member State under the SSTA may enact legislation. This legislation must be consistent with the SSUTA, requiring remote vendors, not qualifying for the small business exception, to collect and remit sales and use taxes on remote sales to purchasers located in the Member State. The Act requires participating states to bear the cost of collection and to provide reasonable compensation to the remote vendors for the cost of collection. Under the SSTA states are required to employ uniform destination based sourcing rules, that is, rules associated with the location of the taxable transaction.

The provisions of the SSUTA give the states the choice to become Member States under the SSTA or remain outside the Agreement. The incentive for states to become Member States is the ability to collect sales and use tax revenues. Non-Member States are still permitted to seek collection of these taxes from remote vendors as under current law. However, to be successful the state would have to overcome both the Due Process and Commerce Clause issues discussed previously. Success would be unlikely, especially since Congress would have provided a constitutional means to collect these taxes under the SSUTA.

In the House of Representatives, this Act is currently being considered by the House Committee on the Judiciary’s Subcommittee on Commercial and Administrative Law. In the Senate, the SSUTA has been referred to the Committee on Finance. This Act has strong bipartisan support from both state governors and members of Congress. If enacted, the SSUTA will provide a national solution. Eventually, states will need to approve the SSTA or forgo tax revenues. The SSUTA only applies to transactions within the United States. The taxation of extraterritorial transactions remains unchanged, i.e., regulated by treaty, custom levy, and duties.

7. Conclusion

The obligation of remote vendors to collect and remit state and local sales and use taxes is a difficult, but not a new issue. The issue is becoming more salient as e-commerce sales continue to increase. For example, holiday shopping during November 2003 resulted in 55% more online spending than November 2002, resulting in sales of US\$8.5 billion [Greenspan 2003]. These increased sales could be an important source of increased tax revenues for cash strapped states.

Currently, the ability of states to collect taxes from remote e-commerce vendors is confused. The consequence is that a remote vendor's obligation to collect and remit taxes must be decided on a case by case basis by addressing questions such as: Does a remote vendor have a sufficient "presence" within the taxing jurisdiction? Would the imposition on the remote vendor of the obligation to collect and remit taxes be so unduly burdensome as to be unconstitutional? The remote vendor has legitimate concerns about excessive compliance costs if the obligation to collect and remit sales and use taxes from multiple jurisdictions requiring different tax bases, rates, forms and procedures is imposed. These factual questions necessitate a cumbersome and uncertain case by case determination. From a practical perspective, this current situation is not a viable tax system and is unfair both to state governments and remote e-commerce vendors. Rather than expending resources in case by case determinations, a solution is needed that is fair to all parties. Within the United States this is a national problem and requires a national solution. The United States Supreme Court has invited the Congress to act, but all Congress has done is to create and then extend a misunderstood moratorium. The enactment of the Streamlined Sales and Use Tax Act would bring tax certainty to states and remote vendors, and provide a uniform tax system for both in state and remote vendors.

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