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Internet Taxation Without Physical Representation?: States Seek Solution to Stop E-Commerce Sales Tax Shortfall

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INTERNET TAXATION WITHOUT PHYSICAL REPRESENTATION?: STATES SEEK SOLUTION TO STOP E-COMMERCE SALES TAX SHORTFALL

I. INTRODUCTION

"Why pay more when you can pay less?" In addition to being used in marketing campaigns, this phrase has become the governing principle for many of today's Internet[1] shoppers. Unfortunately for revenue-seeking states, what enables consumers to pay less may not be competitive retail pricing, but the absence of sales tax charged on Internet purchases.

The Internet has unquestionably impacted commerce from the consumer, vendor, and governmental perspectives, giving consumers unprecedented access to vendors in all states and internationally without leaving home.[2] The ease with which consumers and vendors are able to transact business over long distances has created a host of novel problems for state governments generally, and the amorphous nature of the Internet has had a particularly acute effect on taxation of retail sales.[3]

It is well settled that in intrastate transactions a seller can be required to collect and remit sales taxes to the state revenue agency.[4] Equally well settled is that a consumer who purchases goods from an out-of-state, or remote, vendor in a transaction where sales tax is not charged, must self-report a use tax to the state where the product is consumed.[5] Few consumers actually report such transactions or remit a use tax,[6] despite being legally required,

1. The Internet is collectively defined as "the myriad of computer and telecommunications facilities, including equipment and operating software, which comprise the interconnected world-wide network of networks that employ the Transmission Control Protocol/Internet Protocol, or any predecessor or successor protocols to such protocol, to communicate information of all kinds by wire or radio." Internet Tax Freedom Act, Pub. L. No. 105-277, § 1104(4), 112 Stat. 2681 (1998).

2. *See* Dennis M. Kennedy, *Key Legal Concerns in E-Commerce: The Law Comes to the New Frontier*, 18 T.M. COOLEY L. REV. 17, 18 (2001) (describing the myriad services available to consumers through the Internet).

3. *See* discussion *infra* at notes 50–54.

4. Timothy A. Hart, *Taxing E-Commerce: The Sales and Use Tax Question*, 37 TULSA L. REV. 397, 398 (2001).

5. *Id.*

6. *Id.*; Ryan J. Swartz, *The Imposition of Sales and Use Taxes on E-Commerce: A Taxing Dilemma for States and Remote Sellers*, 2 J. HIGH TECH. L. 143, 144 (2003).

either because they are unaware of their obligation,[7] or because of the negligible risk of being caught.[8]

Historically, consumer noncompliance was tolerated because the cost of collecting the tax outstripped the revenues generated.[9] The proliferation of Internet sales has changed this equation. The prevalence of out-of-state transactions consummated over the Internet has vastly increased the volume of revenue being lost to states, and has created a corresponding rise in the importance of collecting a use tax.[10]

Remote vendors, however, cannot be forced to collect sales or use taxes from consumers unless the vendor has a substantial nexus within the taxing jurisdiction.[11] The substantial nexus test is frustrated by the shapeless nature of the Internet, which allows e-tailers[12] to be physically present in only one state while selling goods in every other state and internationally.[13] The current law arises from the Supreme Court's decisions relating to mail-order catalogue sales, arguably the most nearly analogous method of transacting sales. In particular, *National Bellas Hess, Inc. v. Department of Revenue of Illinois*[14] and *Quill Corp. v. North Dakota*[15] invoked the Due Process[16] and Commerce Clauses[17] to restrict a state's ability to force remote vendors to collect a use tax.[18] In *Quill*, the Court invited Congress to take action in this politically charged area to reach a decision that would appease the numerous competing

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7. Jaime Klima, *Mom & Pop v. Dot-com: A Disparity in Taxation Based on How You Shop?*, 2002 DUKE L. & TECH. REV. 28, ¶ 15, http://www.law.duke.edu/journals/dltr/articles/2002dltr0028.html.

8. *See* Brian S. Masterson, *Collecting Sales and Use Tax on Electronic Commerce: E-Confusion or E-Collection*, 79 N.C. L. REV. 203, 221 (2000) (discussing the potential economic discrimination present to underprivileged consumers who cannot participate in e-commerce or benefit from the resulting absence of sales tax).

9. Hart, *supra* note 4, at 400–01 (noting the costs inherent in hiring additional personnel to conduct audits of numerous low-dollar transactions and to prosecute violations).

10. *Id.*

11. *See* discussion *infra* at notes 75–91.

12. An "e-tailer" is a vendor that engages in electronic commerce. Electronic commerce means "any transaction conducted over the Internet or through Internet access, comprising the sale, lease, license, offer, or delivery of property, goods, services, or information, whether or not for consideration, and includes the provision of Internet access." Internet Tax Freedom Act, Pub. L. No. 105-277, § 1104(3), 112 Stat. 2681 (1998).

13. Hart, *supra* note 4, at 401.

14. 386 U.S. 754 (1967).

15. 504 U.S. 298 (1992).

16. "No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any state deprive any person of life, liberty, or property without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws." U.S. CONST. amend. XIV, § 1.

17. "The Congress shall have Power To . . . regulate commerce with foreign nations, and among the several States." U.S. CONST. art. I, § 8, cl. 3.

18. *See* discussion *infra*.

interests.[19] States have not waited on the sidelines for Congress to accept this invitation, but in an effort to satisfy the constitutional roadblocks, have drafted an agreement that if fully complied with would alleviate burdens on remote vendors and achieve taxing uniformity.[20]

This Article begins with a general discussion of sales and use taxes. Next, it will discuss the difficulties of collecting a use tax and the constitutional impediments that preclude a state from forcing a remote vendor lacking a substantial nexus with the taxing state to collect use taxes. The Article will then examine actions Congress has taken to reach a solution, as well as the states' own initiatives to prevent Internet transactions from crippling their revenue collection. The Article concludes with a defense of the state-led initiative and suggestions to increase the effectiveness and efficiency of use tax collection on individual taxpayers.

II. SALES TAX

The most common and substantial form of sales tax is that applied to retail sales.[21] It is usually levied on sales or leases of tangible personal property, but is extended to cover intangible products and services in some taxing jurisdictions.[22] The sales tax originated in the Mississippi legislature in 1932 as a revenue-generating measure in response to the Great Depression.[23] It has since spread into forty-five states and the District of Columbia.[24] Currently, more than 7,600 state and local governments impose a sales tax,[25] which along

19. *Quill*, 504 U.S. at 318 ("[T]he underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve.").

20. *See* discussion *infra*.

21. Shane Padgett Morris, *Interstate Commerce and the Future of State Sales and Use Taxes*, 54 ALA. L. REV. 1393, 1395 (2003).

22. *Id*. ("[A] sales tax by definition in most states is imposed on the sale of all tangible personal property except property specifically excluded, but it is not imposed on the sale of services unless the service is specifically included.").

23. John E. Sununu, *The Taxation of Internet Commerce*, 39 HARV. J. ON LEGIS. 325, 326 (2002).

24. *Id*. at 327. No sales or use tax is imposed in Alaska, Delaware, Montana, New Hampshire, or Oregon. *Id.* at 327 n.9.

25. Swartz, *supra* note 6, at 144; *see also* ADVISORY COMMISSION ON ELECTRONIC COMMERCE, REPORT TO CONGRESS, 17 (Apr. 2000), *available at* http://www.ecommercecommission.org. Of the forty-five states that impose a sales tax, thirty-three allow local jurisdictions to impose an additional sales tax. *See* ADVISORY COMMISSION ON ELECTRONIC COMMERCE, *supra*, at 17; David T. Brown, Note, *No Easy Solutions in the Sales Tax on E-Commerce Debate: Lessons from the Advisory Commission on Electronic Commerce Report to Congress*, 27 J. CORP. L. 117, 119 (2001).

with use tax, accounted for more than one-third (35.8%) of total revenue for the states in 2004.[26]

The sales tax is distinct from income and use taxes in that the burden is on the vendor rather than the consumer to collect and remit it to the proper governmental body.[27] As will be discussed, this obligation only rests on a vendor if it has a substantial nexus within the taxing state. Therefore, vendors that operate largely over the Internet or through mail-order catalogues may escape the onerous administrative burden of collecting and remitting sales tax on the consumer's behalf for sales made to out-of-state buyers.[28] For those consumers and transactions, the use tax takes effect.

III. USE TAX

"A use tax is defined in most states as a tax on the use, storage, or consumption of tangible personal property within the state."[29] Rather than being a tax burden in addition to sales tax, the use tax is complementary, and is applied to the use of products within a state not previously subjected to a sales tax.[30] The main difference between the use and sales tax is purchaser location.[31] An intrastate transaction will trigger a sales tax, whereas an interstate transaction will generate a use tax.[32] States utilize use taxes to discourage their residents from purchasing products out-of-state in order to avoid sales tax.[33] Therefore, the use tax rate in a state is typically identical to the rate charged for state sales tax.[34] To prevent being taxed twice on the same purchase, and to avoid a resulting dormant Commerce Clause challenge, a taxpayer must receive a credit against a state's use tax for any sales tax paid in another state.[35]

In theory, the combination of sales and use taxes should lead to the proper collection of tax on all eligible transactions, whether made within or outside the taxing state. For example, a consumer who makes a traditional purchase

26. Todd Stanford Snyder, *Ending the Internet Tax Moratorium*, 60 J. MO. B. 66, 67 (2004); *see* U.S. BUREAU OF THE CENSUS, NATIONAL TOTALS OF STATE TAX REVENUE, BY TYPE OF TAX, (Nov. 19, 2004), *available at* http://www.census.gov/govs/qtax.

27. Swartz, *supra* note 6, at 144.

28. *See id*. at 143 (discussing e-tailers' ability to exploit sales tax laws when sales are made to out-of-state consumers).

29. Morris, *supra* note 21, at 1396.

30. *Id.*

31. Sununu, *supra* note 23, at 327.

32. *Id.*

33. Swartz, *supra* note 6, at 144.

34. *See* Klima, *supra* note 7, at ¶ 15. Sales tax rates range from one percent to eleven percent in some local jurisdictions. Sununu, *supra* note 23, at 327.

35. This is an example of the application of the "dormant" Commerce Clause. In this capacity it represents a limitation on a state's ability to hinder interstate commerce by means of double taxation. *See* Morris, *supra* note 21, at 1396.

from the corner brick-and-mortar store will pay sales tax because the vendor is required to collect and remit the tax to the state's department of revenue. Likewise, a sale made through a remote vendor (a vendor without a physical presence in the taxing state), whether a traditional mail-order vendor or an e-tailer, will obligate the purchaser to self-report the tax in the form of a use tax.[36] In either situation, the state will receive the tax revenue without any "tax leakage."

IV. REALITY DEPARTS FROM THEORY

A. Tax Leakage

Despite the theoretical balance created by sales and use taxes, the reality is far different,[37] and use taxes go largely uncollected.[38] Indeed, the use tax has been called the "most ignored tax on the books."[39] Failure to collect tax revenue has not been created because e-commerce is not taxed; rather, "[t]he problem is that the ability to transact untaxed commerce is now exponentially easier than it has ever been in the history of the world."[40] The lack of collection has two main causes.[41] First, most consumers are unaware of the obligation to self-report use tax.[42] A common misperception is that if the vendor does not collect a sales tax, then the consumer is under no obligation to pay. Second, this misperception is perpetuated among consumers because the payment of use tax is rarely enforced.[43] States have substantial difficulty in monitoring and collecting consumers' use tax payments.[44] No reliable audit procedure exists that can accurately and economically determine an individual's purchasing behavior.[45] Major consumer purchases, such as automobiles, which require the purchase to be registered with the state, are one

36. *See* Hart, *supra* note 4, at 398.

37. The National Governors Association estimated that state governments lost $27 billion in 2004 from uncollected online sales taxes and would lose another $41 billion in 2005. Ian Ritter, *Fight Heats Up over E-tail Tax*, Apr. 2003, http://www.icsc.org/srch/sct/current.

38. *See* Masterson, *supra* note 8, at 206 ("Absent substantive reform in the collection of use tax on interstate commerce, the states will continue to lose use tax revenue that buyers clearly owe under existing laws.").

39. H.R. REP. NO. 107-240, at 37 (2001).

40. Hart, *supra* note 4, at 401.

41. *See id*. at 398 ("Nexus determination and calculation of [sales and use tax] are the main challenges for sellers, while ignorance and enforceability are the biggest obstacles to consumer collection.").

42. Swartz, *supra* note 6, at 144.

43. Masterson, *supra* note 8, at 205.

44. Sununu, *supra* note 23, at 327–28.

45. *See id*. at 328.

of the few areas where use tax payments are regularly collected.[46] A registration requirement is, however, impractical with small, everyday purchases.[47] In addition, the tracking of Internet purchasing behavior to determine compliance with use tax laws would create a host of technological and privacy concerns.[48]

A final hurdle to use tax collection is simple non-cooperation with tax laws.[49] Even for the rare consumer who is aware of the obligation to remit use taxes, the knowledge that disobedience will likely go unpunished contributes to the problem. Use tax non-compliance before the widespread use of the Internet primarily occurred through purchases made by mail-order catalogues and high-priced items shipped out of state, such as furniture and jewelry.[50] While this loss of tax revenue has always troubled states, the advent of the Internet has exacerbated use tax leakage.[51] Now, consumers may purchase virtually any item through a remote e-tailer that lacks substantial nexus with the taxing state, thereby avoiding sales tax, and may choose not to voluntarily pay use tax, secure in the knowledge that this choice will likely go undetected and unchallenged by the state. Currently, Internet purchases make up only 2.2% of total retail sales;[52] however, the growth of such sales has been exponential, increasing at four times the rate of overall retail sales.[53] It is estimated that this growth, coupled with the lack of use tax collection, could lead to a loss in state tax revenue of $55 billion during the next ten years.[54]

As the Internet continues to grow in popularity, successful tax collection under the current system will inevitably continue to deteriorate.[55] States are concerned that the current trend, if continued, will eviscerate their ability to

46. *See* JOHN F. DUE & JOHN L. MIKESELL, SALES TAXATION: STATE AND LOCAL STRUCTURE AND ADMINISTRATION 275 (2d ed. 1994); Charles E. McLure, Jr., *Sales and Use Taxes on Electronic Commerce: Legal, Economic, Administrative, and Political Issues*, 34 URB. LAW. 487, 489 (2002).

47. *See* Swartz, *supra* note 6, at 144 ("Taxing authorities have difficulty identifying the online purchasing activity of buyers, making enforcement of the use tax administratively impossible.").

48. *See id*.

49. *See* Klima, *supra* note 7, at ¶ 1.

50. *See* DUE & MIKESELL, *supra* note 46, at 275; Sununu, *supra* note 23, at 331 (discussing the argument that the development of the Internet created a "legal loophole" exempting new classes of transactions from sales tax).

51. *See* Klima, *supra* note 7, at ¶ 13 (comparing the explosive growth of Internet sales with the modest growth of traditional retail sales).

52. Press Release, U.S. Census Bureau, Quarterly Retail E-Commerce Sales 2nd Quarter 2005 (Aug. 19, 2005), http://www.census.gov/mrts/www/data/pdf/05Q2.pdf.

53. Klima, *supra* note 7, at ¶ 13.

54. *See id*. at ¶ 14.

55. *See* Sununu, *supra* note 23, at 328 (arguing that a national approach to the taxing dilemma has increased in importance as the Internet grows in popularity).

perform basic governmental functions.[56] The failure to collect use tax from individual consumers may cause states to focus on collections from remote vendors as a solution.[57] This would be an optimal answer, but the Supreme Court has seemingly foreclosed that option by holding that the ability of a state to require remote vendors to collect use tax is limited to those remote vendors with a substantial nexus in the taxing state.[58]

B. Constitutional Preclusion

The imposition of taxes on remote vendors triggers two potential constitutional challenges. First, the Due Process Clause prevents a state from taxing entities over which it does not have jurisdiction.[59] Second, the dormant Commerce Clause prevents a state from unfairly burdening interstate commerce.[60] These constitutional issues only arise in the context of use taxes, as opposed to sales taxes, since sales taxes by nature apply solely to intrastate transactions in which a state clearly has jurisdiction over the seller and no interstate trade is affected.[61] The use tax, however, is implicated in interstate sales, where a state may not have the required jurisdiction and interstate trade would be burdened by tax collection regulations.[62]

Currently, it appears no statutory authority governs what "minimum contacts"[63] are necessary to establish jurisdiction over a remote vendor. Likewise, no statute dictates what "substantial nexus"[64] a remote vendor must have with a taxing state to satisfy the Commerce Clause. Despite this lack of guidance, the Supreme Court has spoken in the analogous area of mail-order sales.[65] The seminal Supreme Court cases in this area are *National Bellas*

56. *See generally id*. at 326–27 (noting that the sales tax has been the largest source of state revenue for over fifty years).

57. *See generally* Morris, *supra* note 21, at 1393–94.

58. Quill Corp. v. North Dakota, 504 U.S. 298, 313 (1992).

59. *See* Morris, *supra* note 21, at 1399.

60. *See id*.; *Quill*, 504 U.S. at 309, 313. The "dormant" nature of the Commerce Clause recognizes that the Commerce Clause acts not solely as a source of congressional authority, but also implicitly as a limitation on state power. *See* Sununu, *supra* note 23, at 329. "[T]he Commerce Clause is more than an affirmative grant of power; it has a negative sweep as well . . . ." *Id.* (quoting *Quill*, 504 U.S. at 309). "The Clause . . . prohibits certain state actions that interfere with interstate commerce." *Id*. (quoting *Quill*, 504 U.S. at 309).

61. Morris, *supra* note 21, at 1398 (noting that a retail sales tax is always intrastate, and therefore personal jurisdiction to tax a purchaser buying property within the taxing state always exists).

62. *See id*.

63. *See* Int'l Shoe Co. v. Wash., Office of Unemployment Comp. and Placement, 326 U.S. 310, 316 (1945).

64. *See Quill*, 504 U.S. at 313; Snyder, *supra* note 26, at 67.

65. Snyder, *supra* note 26, at 67.

Hess, Inc. v. Department of Revenue of Illinois[66] and *Quill Corp. v. North Dakota*.[67]

National Bellas Hess (National) was incorporated in Delaware and had its principal place of business in Missouri.[68] National's incorporation and principal place of business clearly amounted to personal jurisdiction in and a substantial nexus within those states, subjecting it to an obligation to collect sales tax therein.[69] National also conducted a mail-order business in several other states, including Illinois, but contact with customers in those states was limited to mailing catalogues to them.[70] It appealed from a judgment of the Illinois Supreme Court that required it to calculate, collect, and remit use taxes to the Illinois Department of Revenue,[71] citing the Commerce Clause and Due Process Clause.[72] The Court noted that in some instances a state may require a remote vendor to collect and remit a use tax, but nevertheless reversed the lower court, stating that it "has never held that a State may impose the duty of use tax collection and payment upon a seller whose only connection with customers in the State is by common carrier or the United States mail."[73] In its decision, the Court held that actual physical presence in a state is necessary under both Due Process and the Commerce Clauses before that state can force the collection of a use tax.[74]

The Court in *Quill v. North Dakota* limited its physical presence test, as it applied to due process, distinguishing between the requirements of the two clauses.[75] Quill was registered in Delaware with offices and warehouses in Illinois, California, and Georgia.[76] Again, it was undisputed that Quill could be required to collect and remit use taxes for sales to consumers in those states. Although Quill did not own property in North Dakota and none of his

66. 386 U.S. 753 (1967).

67. 504 U.S. 298 (1992).

68. *Nat'l Bellas Hess*, 386 U.S. at 753–54.

69. *See id*. at 756; *see also* Int'l Shoe Co. v. Wash., Office of Unemployment Comp. and Placement, 326 U.S. 310, 316 (1945) ("[D]ue process requires only that in order to subject a defendant to a judgment in personam . . . he have certain minimum contacts" with the taxing state to satisfy "traditional notions of fair play and substantial justice.").

70. *Nat'l Bellas Hess*, 386 U.S. at 754.

71. *Id*.

72. *Id*. at 756.

73. *Id*. at 758.

74. *See id*. at 758–60. The Court reversed the Illinois judgment, emphasizing the "sharp distinction" between a remote vendor with a physical presence in a taxing state and a vendor without physical presence. *Id*. *But see* Michael T. Fatale, *State Tax Jurisdiction and the Mythical "Physical Presence" Constitutional Standard*, 54 TAX LAW. 105, 107 (2000) (arguing that physical presence is not a necessary precondition for the assertion of state tax nexus).

75. Quill Corp. v. North Dakota, 504 U.S. 298, 312 (1992) (stating that the clauses reflect "different constitutional concerns").

76. *Id*. at 302.

employees worked in that state, he did sell office equipment and supplies there.[77] Quill was forced to collect use tax on North Dakota sales by a state tax law conferring personal jurisdiction on "every person who engages in regular or systematic solicitation of a consumer market in th[e] state."[78]

The Court found that the state tax law was an undue burden on interstate commerce, stressing that the Due Process and Commerce Clauses have different purposes and policies.[79] The Court stated that "[d]espite the similarity in phrasing, the nexus requirements of the Due Process and Commerce Clauses are not identical."[80] The Due Process Clause "concerns the fundamental fairness of governmental activity."[81] The nexus requirement under due process requires an individual's connections to be "substantial enough to legitimate the State's exercise of power over him."[82] The Court made it clear that the Due Process Clause was not an impediment to the collection of use tax under the facts in *Quill*, thereby allowing a state to impose a duty to collect use taxes on a vendor that continually and broadly solicits business with a state.[83] This test departs from the requirement of physical presence set forth in *National* and instead focuses on a minimum contacts analysis.[84]

Despite meeting the minimum contacts requirement of due process, to pass constitutional muster the tax must also be valid under the Commerce Clause.[85] The negative sweep of the Commerce Clause prevents states from unduly burdening interstate commerce. The Court explained that there is no undue burden in imposing a requirement to collect use tax on a vendor that has a substantial nexus with the taxing state.[86] The Court clarified that it is possible to "have the 'minimum contacts' with a taxing State as required by the Due Process Clause, and yet lack the 'substantial nexus' with that State as required by the Commerce Clause."[87]

77. *Id*.

78. *Id*. at 302–03 (quoting N.D. CENT. CODE § 57-40.2-07(6) (1987)).

79. *See id*. at 305.

80. *Quill*, 504 U.S. at 312.

81. *Id*.

82. *Id*.

83. *See id*. at 313; *see also* Int'l Shoe Co. v. Wash., Office of Unemployment Comp. and Placement, 326 U.S. 310, 317 (1945) ("'Presence' in the state . . . has never been doubted when the activities of the corporation there have . . . been continuous and systematic . . . .").

84. *Quill*, 504 U.S. at 313; *see Int'l Shoe*, 326 U.S. at 316.

85. *See Quill*, 504 U.S. at 312–13. In recognizing the difference between the Due Process and Commerce Clauses the Court stated that "[t]he two standards are animated by different constitutional concerns and policies." *Id*. at 312.

86. *Id*. at 313 ("[T]he 'substantial nexus' requirement is not, like due process'[s] 'minimum contacts' requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce.").

87. *Id*.

In *Quill*, the Court reaffirmed that a substantial nexus is not present when a vendor's "only connection with customers in the State is by common carrier" or advertising.[88] Although the *Quill* Court broke away from the physical presence test in analyzing the Due Process Clause, the substantial nexus threshold has continued to be interpreted to require a physical presence in the taxing state to satisfy the Commerce Clause.[89]

The physical presence required to achieve substantial nexus with the taxing state is inevitably an impediment on states attempting to force out-of-state mail-order vendors to collect use tax. The substantial nexus test is also implicated by analogy to remote vendors who solicit business in other states largely through the Internet.[90] E-tailers can rely on the logic of *Quill* as a safe harbor, protecting remote vendors from the burden of collecting and remitting use taxes.[91] The states have lamented the Supreme Court's decisions in the area of remote taxation because of the tax leakage they have caused in relation to mail-order vendors.[92] The opposition to the Court's decisions has steadily grown as Internet vendors have utilized this safe harbor, thereby costing the states increasingly more revenue as the Internet grows in popularity.[93] Resistance to the physical presence requirement has also become more contentious, as major retailers have found ways to exploit the substantial nexus test, thereby receiving the many benefits of ubiquitous Internet commerce while avoiding use tax collections in all but one state.[94] As an example, Wal-Mart Stores, Inc. has a physical storefront presence in every state, but its online subsidiary is only physically present in nine states.[95] Since the courts historically respect formal legal organization, this allows the online subsidiary to avoid collecting use taxes in all states except nine, despite the storefront physical presence in every state.[96]

88. *Id*. at 301 (quoting Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Ill., 386 U.S. 753, 758 (1967)).

89. *Id*. at 317–18.

90. *See* Klima, *supra* note 7, at ¶ 8 (stating that although "there is no direct implication from mail-order to e-retailers, most Internet companies assume that the *Quill* decision applies to them because the two industries share the defining characteristic of an ability to sell in many places without maintaining a physical presence").

91. *See* Swartz, *supra* note 6, at 146.

92. *See* McLure, *supra* note 46, at 495–96.

93. *See* Morris, *supra* note 21, at 1403 (describing that although states begrudgingly accepted the physical presence test for mail-order sales, they have become "far more vocal" as the Internet has grown in popularity).

94. *See* Swartz, *supra* note 6, at 143.

95. Brian Krebs & Jonathan Krim, *Big Stores to Charge Sales Taxes Online*, WASH. POST, Feb. 7, 2003, at A01; *see* Swartz, *supra* note 6, at 143 n.11.

96. *See* Nathaniel T. Trelease & Andrew W. Swain, *Nexus and Remote Sellers: The Taxation of Electronic Commerce*, COLO. LAW., Feb. 2002, at 75, 77–78 (2002); *see also* Snyder, *supra* note 26, at 69 (noting that although not legally obligated, some retailers, including Wal-

V. POTENTIAL SOLUTIONS

In *Quill*, the Court essentially invited congressional action in the area of Internet sales taxation.[97] By separating the physical presence test from the Due Process Clause and substituting a minimum contacts analysis, the Court seemingly opened the door for Congress to act.[98] This results because Congress may pass legislation, under its plenary power, authorizing states to burden interstate commerce without violating the Commerce Clause; however, Congress does not have this power with respect to the Due Process Clause.[99] The Court, in removing the barrier of the Due Process Clause and recognizing Congress's broad authority under the Commerce Clause, stated, "No matter how we evaluate the burdens that use taxes impose on interstate commerce, Congress remains free to disagree with our conclusions. . . . Congress is now free to decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes."[100] Thus it is clear that Congress has the power to eliminate the physical presence required to achieve substantial nexus and substitute another, less onerous, measure of nexus.[101] To date, Congress has ignored the invitation. As pressure continues to build from states and traditional brick-and-mortar vendors, Congress should act decisively to put all vendors on equal footing. The actions taken to date have probably only contributed to the growing problem of use tax leakage.

Mart Stores, Inc. have "voluntarily begun collecting sales and use taxes on online purchases, including purchases made by customers in states where the retailer does not have a physical presence"). Those supporting e-tailers' freedom from collecting use taxes have argued that the "voluntary" collection by Wal-Mart Stores, Inc. and other major retailers was done not to support the states' right to collect use taxes on out-of-state vendors. Rather, they argue it was done because the retailers wanted customers to be able to return merchandise purchased online to physical storefronts, and this interaction between the separate entities would forfeit the autonomy between the online subsidiary and physical storefront obligating the merchandiser to collect use taxes under current law. *See* Krebs & Krim, *supra* note 95. Therefore, the merchandisers receive favorable coverage in the press for what they would be obligated to do anyway. *See id.* ("'This is a well-timed PR stunt,' said H. Robert Wientzen, chief executive of the Direct Marketers Association. Wietzen said the retailers that agreed to collect sales tax have stores in most states—which means they should be collecting taxes on online sales anyway—and they are major corporations that have the computer resources to handle the nation's many tax rates.").

97. 504 U.S. 298, 318 (1992).

98. *See id*. at 312 ("Despite the similarity in phrasing, the nexus requirements of the Due Process and Commerce Clauses are not identical.").

99. *Id*. at 305 ("While Congress has plenary power to regulate commerce among the States and thus may authorize state actions that burden interstate commerce . . . it does not similarly . . . have the power to authorize violations of the Due Process Clause.") (internal citations omitted).

100. *Id*. at 318.

101. *See id*. *See generally* Trelease & Swain, *supra* note 96, at 76–78 (suggesting several alternatives to the physical presence test to establish substantial nexus with the taxing state).

A. New Economy Tax Fairness Act

A bill proposed in the 107th Congress, the New Economy Tax Fairness Act (Net Fair Act),[102] sought to codify the judicially created framework in *Quill* rather than introduce a separate solution. The Net Fair Act lists potential business activities that are not individually, nor in conjunction with other listed activities, sufficient to establish a physical presence in the buyer's state.[103] Therefore, participation in any of the listed activities alone would provide an explicit safe harbor within which remote vendors could not be forced to collect and remit use taxes. The provision most germane to the topic of taxation of Internet commerce is one providing that a buyer's mere access to a remote vendor's Web site does not create a physical presence within that state.[104] Not surprisingly, the Net Fair Act has been strongly endorsed by e-retailers as a potential solution, but strong opposition by states and traditional retailers has prevented this alternative from receiving serious attention.[105]

B. Internet Tax Freedom Act of 1998

Congress' first regulation of Internet taxation delayed finding a permanent solution to the problem. In 1998 Congress enacted the Internet Tax Freedom Act (ITFA), which created a three-year moratorium on Internet taxes.[106] During this three-year period, states were precluded from imposing new taxes on Internet access charges and from imposing discriminatory taxes on Internet

102. S. 664, 107th Cong. (2001).

103. *Id*. § 101(a). Among the activities listed that will not establish nexus with a buyer's state are:

> (1) The solicitation of orders or contracts by such person or such person's representative in such State for sales of tangible or intangible personal property or services, which orders or contracts are approved or rejected outside the State, and, if approved, are fulfilled by shipment or delivery of such property from a point outside the State or the performance of such services outside the State.
>
> . . . .
>
> (4) The use of the Internet to create or maintain a World Wide Web site accessible by persons in such State.
>
> (5) The use of an Internet service provider, on-line service provider, internetwork communication service provider, or other Internet access service provider, or World Wide Web hosting services to maintain or take and process orders via a web page or site on a computer that is physically located in such State.
>
> (6) The use of any service provider for transmission of communications, whether by cable, satellite, radio, telecommunications, or other similar system.

Id.

104. *Id*. § 101(a)(4).

105. *See* Swartz, *supra* note 6, at 147–48.

106. Pub. L. No. 105-277, §1101(a), 112 Stat. 2681–719.

commerce.[107] The ITFA did not forestall taxes on all Internet commerce, but rather prevented the creation of new taxes.[108] States that already had a functioning tax on Internet access charges were not affected because of a "grandfather" clause.[109] In addition, states could still force remote vendors to collect and remit use taxes, as long as the substantial nexus test of *Quill* is satisfied.[110] The discriminatory prong of the moratorium prevented states from charging higher tax rates on Internet vendors than were charged to traditional brick-and-mortar vendors for the same products,[111] thereby providing a legislative mandate benefiting e-commerce at the expense of traditional storefront commercial operations.

The Internet growth that thrived under the ITFA prompted Congress to extend its protection for another two years. In 2001, the Internet Nondiscrimination Act was passed, which secured the benefits of the ITFA moratorium through November 1, 2003.[112] This date has passed without Congress taking further definitive action.[113] Several proposals were considered by the 108th Congress, including a couple that would make the moratorium permanent,[114] and one that would extend the moratorium through 2008,[115] but none were ultimately passed by both houses of Congress. A primary reason for the failure to reach an agreement on the future of the ITFA before it expired was the inability to reach a consensus on the definition of "Internet access."[116] Members of Congress were fearful that the definition of "Internet access" would be broadened to encompass telecommunications services that provide access to the Internet.[117] If this broad definition were to gain favor, other industries providing telecommunications services, such as cable and telephone, might also be exempt from state and local taxes.[118] The

107. *Id*. ("No State or political subdivision thereof shall impose any of the following taxes during the period beginning on October 1, 1998, and ending three years after the date of the enactment of this Act . . . .").

108. *Id*. § 1101(a)(1) (providing that no State or political subdivision shall impose any . . . tax on Internet access, "unless such tax was generally imposed and actually enforced prior to October 1, 1998 . . . .").

109. *Id*.

110. *See* Swartz, *supra* note 6, at 146.

111. Internet Tax Freedom Act § 1104(2); Swartz, *supra* note 6, at 146.

112. Pub. L. No. 107-75, § 2, 115 Stat. 703 (2001).

113. *See* Snyder, *supra* note 26, at 67 (arguing that reinstating the moratorium with an expanded definition of Internet access "would represent an example of incrementalism serving special telecommunications lobbying concerns").

114. *See, e.g.*, Internet Tax Nondiscrimination Act, H.R. 49, 108th Cong. (2003) (permanent extension); Internet Tax Nondiscrimination Act, S. 150, 108th Cong. (2004) (four-year extension); Internet Tax Nondiscrimination Act, S. 52 108th Cong. (2003) (permanent extension).

115. Internet Growth and Freedom Act of 2003, H.R. 1481, 108th Cong. § 2.

116. Snyder, *supra* note 26, at 66.

117. *Id*.

118. *Id*.

inability to tax these giant industries would result in a further reduction of revenue for the states.[119]

Throughout it all, the lack of congressional guidance has left states in the dark concerning their options to tax Internet commerce. The policy behind the ITFA was to ensure the survival of Internet commerce while in its infancy.[120] Preventing onerous Internet access charges and discriminatory tax rates upon e-commerce vendors, the ITFA fostered a friendly environment for Internet commerce to blossom.[121] The goal of this policy has been met, perhaps too well, and now traditional retailers need to be protected. The phenomenal growth projections of Internet commerce[122] reveal that there is no further need for an Internet taxing moratorium, and the ITFA should not be extended.

In hindsight, the ITFA may be best remembered for its creation of the Advisory Commission on Electronic Commerce (ACEC).[123] The ACEC was established in 1998 for the purpose of studying the effects of taxation on interstate e-commerce.[124] The ACEC's specific charge was to research state and local government efforts to collect sales and use taxes from remote vendors.[125] The ACEC was composed of individuals with varied backgrounds from diverse industries, in order to represent all sides of the Internet taxing question.[126] The nineteen members include three from the federal government, eight from state and local governments, and eight from the e-commerce industry, including small business, telecommunications carriers, local retail businesses, and consumer groups.[127] Although the ACEC failed to garner the required two-thirds vote on issues pertaining to sales and use taxes (the vote required to become a formal legislative recommendation),[128] the ACEC did propose that the states collaborate to simplify sales and use tax compliance.[129] Simplification has since become the focus of the most recent effort to reach a solution to the problem of taxing Internet sales transactions.

119. *Id.*

120. *See* Klima, *supra* note 7, at ¶ 11.

121. *See* Snyder, *supra* note 26, at 66.

122. *Cf.* GLENN J. MCLOUGHLIN, ELECTRONIC COMMERCE: AN INTRODUCTION 1 (2002), *available at* http://usinfo.state.gov/usa/infousa/trade/ecomm/rs20426.pdf ("The rate of e-commerce growth continues so rapidly that projections often are outdated as fast as they are published.").

123. Internet Tax Freedom Act, Pub. L. No. 105-277, § 1102(a), 112 Stat. 2681–722 (1998).

124. *Id*. § 1102(g)(2)(E).

125. *Id*.

126. *See id*. § 1102(b)(1).

127. *Id*. § 1102(a)(1), (b)(1).

128. Internet Tax Freedom Act § 1103.

129. *See* ADVISORY COMMISSION ON ELECTRONIC COMMERCE, *supra* note 25, at 19–20.

C. Streamlined Sales Tax Project

1. Implementation and Organization

The Streamlined Sales and Use Tax Project (SSTP) is the most comprehensive and widely supported attempt to overhaul the current sales and use tax system. It was initiated in March 2000 by a group of states and was sponsored by the National Governors Association (NGA), the National Conference of State Legislatures (NCSL), the Federation of Tax Administrators and the Multistate Tax Commission.[130] Recognizing the obstacles present in requiring out-of-state vendors to collect sales tax, the SSTP focuses on simplifying the current system and relies on a voluntary agreement among the states to collect and remit sales tax to the taxing state.[131] A voluntary agreement, similar to the Uniform Commercial Code, is the states' only option, because they lack an institutionalized forum in which to make binding multilateral decisions.[132] The NGA, NCSL, Federation of Tax Administrators, and Multistate Tax Commission have no independent legislative authority.[133] Therefore, they can only recommend uniform policies to state legislatures who must independently decide whether or not to accept them.[134]

Currently more than forty states have become Streamlined Sales Tax Implementing States (member states).[135] The SSTP issued its initial report (the Streamlined Sales and Use Tax Agreement) (SSUTA)[136] to both the NGA and the NCSL.[137] The NGA adopted the proposed legislation, while the NCSL modified the initial report and issued a unique version.[138] Despite this perceived disagreement, the NGA issued a statement that "[t]here is only one state and local sales and use tax simplification effort underway among the

130. John A. Swain, *State Sales and Use Tax Jurisdiction: An Economic Nexus Standard for the Twenty-first Century*, 38 GA. L. REV. 343, 371 (2003).

131. *See* Swartz, *supra* note 6, at 148 (stating that SSTP implementation is a two-step process consisting of passing enabling legislation and enacting uniform laws as part of the tax code).

132. McLure, *supra* note 46, at 498; *see also* Sununu, *supra* note 23, at 336 ("No state would forego participation in a compact when all other states are forcing businesses to collect taxes from its own citizens for use by outside governments.").

133. McLure, *supra* note 46, at 498.

134. *Id*.

135. Structure and Operating Rules: Streamlined Sales Tax Project, http://www.streamlinedsalestax.org/participatingstates.html (last visited Nov. 15, 2005) [hereinafter SSTP Structure].

136. Streamlined Sales Tax Project, Streamlined Sales and Use Tax Agreement (Adopted Nov. 12, 2002, as amended Apr. 16, 2005) [hereinafter SSUTA], www.streamlinedsalestax.org/agreement.htm.

137. Taxware Resources, *Streamlined Sales Tax Project*, *available at* http://www.taxware.com/taxware_resources/sstp_1.htm (last visited Feb. 1, 2005).

138. *Id*.

states, and there should continue to be only a single simplification effort."[139] To further emphasize the cohesive nature of the SSTP, membership was extended to all states that enacted legislation based on either the SSTP or NCSL version of the tax simplification acts or a hybrid of the two proposals.[140] The member states adopted the original Streamlined Sales and Use Tax Agreement on November 12, 2002.[141] The agreement becomes effective when "at least ten states comprising twenty percent of the total population . . . of all states imposing a sales tax have petitioned for membership and have been found to be in compliance with the [SSTP]."[142] To date, states comprising in excess of twenty percent of the total population of states imposing a sales tax have enacted legislation aimed at bringing these states into compliance with the SSTP, but the required number of states needed to petition for membership has not been met.[143]

The stated purpose of the SSTP is "to simplify and modernize sales and use tax administration in the member states in order to substantially reduce the burden of tax compliance."[144] As mentioned, there are currently more than 7,600 state and local tax codes that vary depending on jurisdiction.[145] Forcing an out-of-state vendor to collect and remit use taxes could potentially require a working knowledge of each state and local tax code.[146] The *Quill* Court considered the cost of this administrative burden when it held that a substantial nexus was required to force tax collection on a remote vendor and to satisfy the Commerce Clause.[147] Without this nexus protection, a start-up e-tailer would be forced to comply with every state and local tax code represented by a purchaser.[148] This cost alone would deter many businesses and slow the

139. National Governors Association, Letter to State Officials (May 4, 2001), http://www.nga.org/portal/site/nga (enter "May 4, 2001" into search box and follow May 4, 2001 – Letter – Streamlined Sales Tax Project hyperlink) (last visited Nov. 16, 2005).

140. *Id*. ("The work of the SSTP and the NCSL are complementary and differ only in the degree of simplification considered achievable in the short term . . . . Each state that passes legislation . . . committing to development and implementation of a streamlined sales tax system should recognize all other states passing such legislation as equal partners . . . regardless of whether the measure enacted is based on the SSTP or NCSL versions or is some hybrid of the two.").

141. *See* SSUTA, *supra* note 136.

142. *Id.* § 701; Swain, *supra* note 130, at 371–72.

143. Swain, *supra* note 130, at 372.

144. SSUTA, *supra* note 136, § 102.

145. Swartz, *supra* note 6, at 144.

146. *See id.* at 148 (stating that if legislation is passed to overturn *Quill*, it will force retailers to "comply with thousands of different tax codes").

147. Quill Corp. v. North Dakota, 504 U.S. 298, 303 (1992) (noting that the North Dakota Supreme Court based its decision partly on the "'welter of complicated obligations' imposed by state and local taxing authorities").

148. *See* Swartz, *supra* note 6, at 149.

growth of e-commerce.[149] Until now, this threat was discharged by the protection of *Quill* and the ITFA. Instead of leveling the playing field, however, the advantage has been shifted to e-tailers. By "simplify[ing] and moderniz[ing] sales and use tax administration" the SSTP seeks to eliminate the burden of compliance costs and treat all sellers equally.[150] Among the key areas that the SSTP includes as part of its simplification effort are uniform definitions of tax bases, fewer tax rates, uniform sourcing rules, less complex tax returns and remittances, and the use of new technological data capturing models.[151]

a. Tax Bases

Legislatures from each state control what is taxable or exempt from taxes in their state.[152] Members of the SSTP, however, agree to use common definitions in their tax laws.[153] Until the end of 2005, local jurisdictions within member states were allowed to have a different tax base than that state as long as it was uniform within those jurisdictions.[154] At the end of that time period, the tax base for all localities and the state tax base were required to be identical.[155]

This agreement is an important simplification from the patchwork of municipal and state rates currently in force, and will require that remote vendors be familiar with only one tax base per state. A few exceptions exist to

149. *Id.*; *see also* Christopher J. Schafer, *Federal Legislation Regarding Taxation of Internet Sales Transactions*, 16 BERKELEY TECH. L.J. 415, 420–22 (2001) (discussing the differences between mail-order and electronic commerce that render "the physical presence standard inapplicable to e-commerce").

150. SSUTA, *supra* note 136, § 102; *see* McLure, *supra* note 46, at 491 (arguing that extant sales and use taxes deviate from an ideal sales tax in part because they do not "apply equally to all sales to consumers").

151. SSUTA, *supra* note 136, § 102. Specifically the SSUTA lists ten areas of focus:

A. State level administration of sales and use tax collections.
B. Uniformity in the state and local tax bases.
C. Uniformity of major tax base definitions.
D. Central, electronic registration system for all member states.
E. Simplification of state and local tax rates.
F. Uniform sourcing rules for all taxable transactions.
G. Simplified administration of exemptions.
H. Simplified tax returns.
I. Simplification of tax remittances.
J. Protection of consumer privacy.

Id.

152. *See* McLure, *supra* note 46, at 503.

153. *See* SSUTA, *supra* note 136, § 327.

154. *Id*. § 302.

155. *Id*.

the requirement that the bases be identical.[156] These apply to products that are separately registered in the state, such as motor vehicles and mobile homes, which do not contribute to the current Internet taxing dilemma.[157]

The move toward tax base simplification comes at an important time in technological development.[158] A tax exemption on transactions from a nonprofit business, intangible products, services, or purchases by a business that are to be resold to the consumer represents decisions based on well-established tax policy; however, new products are being developed that challenge traditional notions of what is "tangible" and whether a transaction represents a service (that would be tax exempt) or a product (that is fully taxable).[159] Digital products are at the forefront of this new type of consumer good.[160] Without a common definition that mandates uniform tax treatment for these new products, they are likely to receive disparate treatment.[161] Similarly situated consumers may then be able to receive virtually the same benefits, but be subject to different tax consequences.[162] For instance, a consumer who purchases an audio compact disc at a "Main Street" store will pay sales tax for this tangible good whereas a consumer who downloads the same compact disc in Mp3 format may escape taxation entirely because the product may be considered intangible.[163] As consumers increasingly gain access to new products available through the Internet, this problem will only be exacerbated. The SSTP common tax base would resolve this problem by treating like products equally.[164] Under the SSUTA a remote Internet vendor would be able to refer to a library of definitions to determine the correct tax that should be collected—an amount that would likely be defined equally to the product available on Main Street.[165]

156. *Id*.

157. *Id*.

158. *See* McLure, *supra* note 46, at 491–92 (arguing that current sales and use taxes deviate from an ideal sales tax in part because they distort consumer purchasing behavior).

159. *See generally id*. at 491 (discussing the four criteria for an ideal sales tax: "(1) sales to business, including sales of capital goods, should not be taxed; (2) taxes should apply equally to all sales to consumers; (3) taxes should apply equally to sales made by local merchants and remote vendors; and (4) taxation should be as simple as possible, consistent with other objectives").

160. *Id*. at 491–92.

161. *Id*.

162. *Id*.

163. *See* McLure, *supra* note 46, at 491–92. This is in addition to the inequity that may result from the imposition of sales tax on the Main Street purchaser and the absence of sales tax charged to the Internet consumer where substantial nexus is absent.

164. *See* SSUTA, *supra* note 136, § 327. The SSUTA's uniform sourcing rules explicitly state that sellers shall source sales in accordance with its provisions "regardless of the characterization of a product as tangible personal property, a digital good, or a service." *Id*. § 309.

165. *See id*. § 327.

It is important to note that tax base uniformity is required only within a state, and not among different states.[166] Although this appears to contradict the policy of simplification, in reality its effect is minimized because the SSUTA contains a library of uniform product definitions.[167] If a term in the library is used in a member state's sales or use tax statutes, that state must adopt the common definition.[168] As the collection of definitions in the library continues to grow, tax bases will become more uniform.[169] In effect then, uniformity is achieved while autonomy is retained by the member states.

b. Tax Rate Simplification

The SSUTA requires that by the end of 2005 all member states use only one state tax rate.[170] Also, local jurisdictions that impose sales and use taxes must use a single common rate.[171] Exceptions that are currently used, such as lower tax rates on food and drugs, will continue to be allowed, as are different rates on property individually registered with the state.[172] Lower rates on food and drugs reflect a social policy of allowing consumers easier access to these vital products, and do not threaten the integrity of the SSTP.[173]

c. Uniform Sourcing Rules

The SSUTA establishes uniform sourcing rules that shift the burden of accurately determining and remitting transaction taxes from the remote seller to the states.[174] In general, the SSUTA includes an agreement that the states will source retail sales of a product according to a hierarchy of rules.[175] In a typical over-the-counter sale, the destination of the sale is obvious: it is the site of the business location.[176] In a remote sales transaction, however, the source

166. Swain, *supra* note 130, at 373.

167. SSUTA, *supra* note 136, app. C, pt. II.

168. *Id*. § 327.

169. *Id.* § 328; *see* Swain, *supra* note 130, at 374 (noting that "[i]t is expected that the library of definitions will continue to expand to cover nearly all possible products, in effect reducing the sales and use tax code of each state to a taxability matrix").

170. SSUTA, *supra* note 136, § 308(A).

171. *Id*. § 308(B).

172. *Id*. § 308(A).

173. Sununu, *supra* note 23, at 327 (highlighting that exemptions for food and medicine, which compose a higher percentage of total consumption for the poor, limit the regressive nature of sales taxes).

174. SSUTA, *supra* note 136, § 301.

175. *Id*. § 310.

176. *Id*. § 310(A)(1); *see* Swain, *supra* note 130, at 375–76 (contrasting the ease at which over-the-counter sellers can comply with existing sales tax laws with the difficulty remote vendors have with complying with the same laws).

of the sale is not always apparent.[177] Because the seller and vendor do not physically meet at the time of the sale, the source could be the location of the vendor, the purchaser's residence or business, or some third-party address where the product is delivered. In the absence of the SSTP, each of these options may have a different local and state tax rate.[178] This ambiguity causes administrative nightmares for remote vendors and may make the cost of doing business unreasonably high. Under the SSUTA, the states bear this burden by providing accurate sourcing information on which sellers rely.[179] In addition, sellers that rely in good faith on the state-provided lists are immune from liability for any errors.[180]

Under the SSUTA the sourcing objective is to approximate destination-based taxation.[181] Therefore, in a remote purchase situation, the sale is sourced to the location where the purchaser receives the product.[182] The destination is based on five- and nine-digit ZIP codes, which solves the problem of matching the taxing jurisdiction to the address.[183]

d. Tax Returns and Remittances

Each member state must provide administration of its sales and use taxes on a state level, thereby obligating remote vendors to register and communicate with only one agency in each state.[184] This substantially mitigates the previous burden of corresponding with numerous local taxing jurisdictions, each with disparate taxing regulations and procedures, within each state. In addition, a vendor only must remit one annual tax return rather than returns submitted quarterly as before.[185] Once vendors remit the proper tax returns and tax receipts to the state, the burden is on the state to correctly distribute the taxes to the local taxing jurisdictions.[186]

Remote vendors will also benefit from the SSTP's provisions on the required notice due on a change of tax rates.[187] States are free to adjust sales or tax rates, but must comply with several requirements aimed at reducing

177. *See* Swain, *supra* note 130, at 375–76 (arguing that from the perspective of remote vendors, the SSTA sourcing rules may be the most important reform).

178. *See id*. at 376.

179. SSUTA, *supra* note 136, § 305.

180. *Id.* § 306.

181. *See id*. § 310; Swain, *supra* note 130, at 376 n.167 (arguing that sound tax policy requires destination sourcing and stating that: "[b]ecause the sales tax is a consumption tax, the jurisdiction in which the consumption occurs [theoretically the location of the purchaser] should be the beneficiary of the tax").

182. SSUTA, *supra* note 136, § 310(A)(2).

183. *See id*. § 305(F).

184. *Id*. § 301.

185. *Id*. § 318(A).

186. *Id*. § 301.

187. SSUTA, *supra* note 136, § 304.

vendors' administrative burdens, including, providing sellers with as much advance notice as possible and limiting the effective date of a change to the first day of a new calendar quarter.[188]

e. Technology

All of the best-laid plans of the SSTP would be unworkable without the aid of new technology.[189] Three potential models have been developed for retailers to use in communicating with states and calculating the proper transaction tax that should be collected and remitted.[190] The states have again agreed to assume responsibility for funding a portion of the technology models. The first model, "Certified Service Provider,"[191] performs all of the vendor's sales and use tax functions.[192] The second model, "Certified Automated System,"[193] serves a tax calculation function, leaving the vendor with the obligation of remitting the proper tax.[194] The third option for a vendor is to develop its own proprietary system that would need to pass a certification test.[195] This option is available only to those vendors who have sales in at least five states and a total annual revenue of five hundred million dollars.[196]

The changes envisioned by the SSTP clearly represent a significant investment of time and money by the states. States are likely willing to shoulder these costs because they believe the expensive administrative procedures involved in coordinating tax bases, rates, financial information, and new technological systems will be offset by the increased revenues generated by plugging the leaks from lost use taxes.[197] In addition, because the Court in *Quill* based its Commerce Clause physical presence requirement on the undue burden use tax collection would cause remote vendors,[198] it is hoped that

188. *Id*.

189. *See* Snyder, *supra* note 26, at 68 (noting that the success of the SSTP is largely dependent on the implementation of new technology).

190. *See* SSUTA, *supra* note 136, §§ 202–07.

191. A Certified Service Provider is defined as "[a]n agent certified under the Agreement to perform all the seller's sales and use tax functions, other than the seller's obligation to remit tax on its own purchases." *Id*. § 203.

192. *Id*. § 205.

193. A Certified Automated System is defined as "[s]oftware certified under the Agreement to calculate the tax imposed by each jurisdiction on a transaction, determine the amount of tax to remit to the appropriate state, and maintain a record of the transaction." *Id*. § 202.

194. *Id*. § 206.

195. SSUTA, *supra* note 136, § 207.

196. *Id*.

197. *Cf.* Swain, *supra* note 130, at 379 ("Membership in SSUTA is a win-win for most states, streamlining tax administration and laying the groundwork for expanded sales and use tax nexus.").

198. *But see id.* at 367 ("[S]ome have argued that *Quill* did not so much create a physical presence test as it did create two safe harbors: one for tax collector-physical presence, and one for

implementation of the SSUTA simplifications would cause the Court to abandon its physical presence requirement in favor of a nexus test that is easier to meet.[199] If this fails, the SSTP would still succeed if Congress accepted *Quill*'s invitation to regulate in the area of interstate commerce and legislatively established a nexus threshold that treats all sellers equitably.[200]

One such alternative to the physical presence standard that is gaining momentum is economic nexus.[201] Economic nexus is defined without reference to a remote vendor's physical presence.[202] Instead, it would be triggered by a remote vendor's delivery of goods to the taxing state.[203] To prevent an undue administrative burden on a remote vendor with only limited sales in a taxing state, a de minimis floor would be established.[204] If the vendor does not exceed this de minimis amount, no use tax obligation could be imposed upon the vendor.[205] Congress should legislatively adopt a similar measure of economic nexus to eliminate the current disparity in Internet taxation and provide horizontal equity between consumers and sellers.[206]

2. Arguments Against the SSTP

Despite the strong support of the states and traditional retailers, the SSTP is not without its detractors. As expected, the most outspoken critics of the proposed new system are remote vendors.[207] They likely recognize that although the SSTP attempts to ease the burden of transaction tax compliance, administrative burdens are not the only costs imposed by requiring the collection of sales tax. Chief among these costs is the forfeiture of the price

the taxpayer-remote sales for which the only contact with the state is by mail or common carrier.").

199. *See id.* at 366–69 (arguing that economic nexus should replace the physical presence test in determining whether a vendor has a substantial nexus with the taxing state). Swain states that

> an economic nexus statute could be enacted that (a) immunizes remote sellers from past potential liabilities, (b) gives a reasonable time to prepare for the new nexus rule before it goes into effect, and (c) possibly even suspends application of the statute, if legally challenged, until a court of final jurisdiction rules on it constitutionality.

Id.

200. *See* Masterson, *supra* note 8, at 209–25 (arguing that the nexus standard be modified to reflect the non-physical nature of e-commerce).

201. *Id*. at 213–14.

202. *Id*. at 214.

203. *Id*.

204. *Id*.

205. *See* Masterson, *supra* note 8, at 214.

206. Swain argues that the nexus issue is simply a balance between the burden on the seller and the benefit to the government. Swain, *supra* note 130, at 355. By lowering the compliance burden, a lower nexus threshold can be justified. *Id.*

207. *See* Swain, *supra* note 130, at 379.

advantage remote vendors currently have over traditional retailers.[208] For instance, if a typical sales tax rate is six percent, a remote vendor could match the price of a traditional retailer and earn six percent more profit. Alternatively, the remote vendor could undercut the retailer's price by six percent while earning the same profit. Either way, the remote vendor has a distinct competitive advantage. Consumers who profit from this advantage (by failing to report the required use tax) have been less resistant to a potential change.[209] This is likely due to a lack of knowledge of the taxing dilemma or a feeling that the taxing loophole was bound to end sometime anyway.[210]

Colorado Gov. William F. Owens has taken up the fight on behalf of consumers and remote vendors.[211] He has criticized the SSTP as a move toward big government that rises to the level of a new tax.[212] Owens argues that the SSTP will increase complexity rather than reduce it, creating "the United Nations of state tax policy."[213] He contends that oversight and implementation of taxing decisions are being "ceded to and dictated by a board of un-elected and unaccountable out-of-state tax bureaucrats."[214]

Owens' comments are off the mark. Although the SSTP adds new technological challenges and requires cooperation among the states, these efforts will result in a reduction in complexity. With uniform tax rates, bases and sourcing rules, among others, remote vendors will be able to comply with every state's sales and use tax laws, whereas before this was administratively impossible.[215] In addition, the SSTP may actually reduce levels of bureaucracy rather than resulting in a larger government. It will be instrumental in eliminating local jurisdictional taxing levels that differ from the state level.[216] This simplification will reduce the need for additional layers of government whose primary purpose is to control the complex interaction between these government levels.

Owens' comments accusing the SSTP of being run by "unelected and unaccountable out-of-state tax bureaucrats"[217] also need to be examined. It is true that the majority of SSTP participants are state revenue department administrators; however, several representatives of state legislatures and local

208. *See* McLure, *supra* note 46, at 495 (noting that granting tax exemption to electronic commerce would give traditional retailers' high-tech competitors an unfair advantage).

209. *See* Swain, *supra* note 130, at 379–80.

210. *Id*. (noting that "tax loopholes, like many things in life, are 'good while they last' but eventually come to an end").

211. *Colorado Gov. Owens Attacks SSTP, Says It Could Create New Tax Burden*, 71 U.S.L.WK. 2814 (2003) [hereinafter *Owens*].

212. *Id*.

213. *Id*. at 2815.

214. *Id*.

215. *See* SSUTA, *supra* note 136, § 102.

216. *See id*. §§ 302, 308(A).

217. *Owens*, *supra* note 211, at 2815.

governments are also involved.[218] Further, as nearly every state is now a part of the SSTP, there is little risk that tax decisions will be made by "out-of-state tax bureaucrats."[219] Owens also underestimates the importance of including unelected officials, such as national retailers, trade associations, manufacturers, technology companies and e-tailers, which have a unique perspective and a large stake in the SSTP.

Owens presents two more arguments for his claim that new tax burdens on Internet purchases will "dampen enthusiasm for Internet usage and stifle technological innovation," and that the SSTP would "disproportionately punish rural, disabled, or even elderly buyers who may find online transactions easier than traditional purchases at brick-and-mortar retailers."[220] Again, these criticisms are rebuttable. First, there seems to be little threat of derailing Internet usage. Internet sales growth continues at an exponential rate and has become the predominant way that many consumers purchase goods.[221] This torrid growth rate is not likely the result of only a lifting of a sales tax burden. Rather, it springs from the convenience online shopping brings to consumers and the ability to purchase and compare goods that are normally not available.[222] Requiring remote vendors to collect sales tax would affect Internet sales only negligibly, and would help level the playing field for traditional retailers.[223]

Second, an argument that rural or disabled consumers would suffer more from an Internet tax is simply without basis. This line of reasoning is irrelevant because the consumers to whom Gov. Owens refers are already legally obligated to remit these taxes in the form of a use tax. Therefore, the implementation of an Internet tax does not affect the burden on these consumers. Instead, it ensures compliance with existing tax laws. Merely because another group of consumers can more readily access traditional retailers if the tax leakage is plugged does not create a heavier burden on consumers who rely on Internet purchases. Consumers who visit a brick-and-mortar store or shop online have the same total tax obligation, whether in the form of a sales tax or a use tax.[224] In fact, if there is a difference, online consumers who pay a use tax currently benefit by delaying the payment of the tax until their individual tax return deadline, whereas sales tax is collected at the point and time of purchase.

218. *See* SSTP Structure, *supra* note 135.

219. *Owens*, *supra* note 211, at 2815.

220. *Id*.

221. *See, e.g.*, Klima, *supra* note 7, at ¶ 13.

222. *See* Sununu, *supra* note 23, at 334.

223. E-fairness, Internet Tax Policy Myths and Facts, http://www.e-fairness.org (last visited Nov. 4, 2005) (stating that "[A] sales tax on Internet purchases 'will not be a significant impediment to the growth of the online retail channel.'").

224. *See* Klima, *supra* note 7, at ¶ 15.

Other, more valid arguments against the SSTP have also been posited. One takes a theoretical approach to counter proponents who justify the need for a current law change by citing changing technology.[225] As the argument goes, changing laws to adapt to technology is most appropriate in situations where new technology offers a means to evade existing outdated laws.[226] Examples include modifying wiretap laws to conform with wireless cellular phones, or altering mail-fraud laws to deal with illegal acts committed through the Internet.[227] This theoretical approach is predicated on the claim that remote Internet sales do not fit into this category because they are no different than traditional phone or mail-order sales and do not require a change in law.[228]

The theoretical argument fails to consider the weight the Court gave to administrative burdens in *National Bellas Hess* and *Quill*. Justice Stewart was concerned with how this type of burden would impact the Commerce Clause when he stated in *National Bellas Hess* that "[t]he many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle [a remote vendor] in a virtual welter of complicated obligations . . . ."[229] Although it is true that remote sales via the Internet are analogous to mail-order or phone sales, the SSTP is not merely concerned with changing technologies, but also in shifting the compliance burden from the remote seller to the member states.[230]

Another argument focuses on the potential negative economic effects that would accompany a departure from the substantial nexus test. Its position is that if the physical presence requirement of the substantial nexus test is eroded, and remote vendors are required to collect and remit use taxes, only firms with an offshore location will receive the advantage of not having to collect transaction taxes.[231] This contention assumes that courts will redefine the substantial nexus test into one based more heavily on economic nexus.[232] As such, retailers may begin moving their operations outside the United States to continue to reap the avoidance advantage of having no sales tax obligation.[233] Ultimately, the relocation of businesses outside the United States along with

225. *See* Sununu, *supra* note 23, at 334–35.

226. *Id*. at 334.

227. *Id*.

228. *Id*. at 334–35.

229. 386 U.S. 753, 759–60 (1967).

230. *See* Swain, *supra* note 130, at 382–83 (noting that the SSTP's simplification efforts will ease the compliance burden, but stating that the best way to end the physical presence test of *Quill* may be to expand the definition of nexus in response to SSTP reforms).

231. Sununu, *supra* note 23, at 336.

232. *See* Swartz, *supra* note 6, at 149 (arguing that "[a]n economic nexus analysis would justifiably capture remote sellers who reap millions of dollars in sales while dodging use tax collection and remittance duties").

233. *See* Sununu *supra* note 23, at 336.

the accompanying relocation of product development and human capital would be detrimental to the economy.

This viewpoint focuses on the potential plight of the economy through lost jobs and business, but fails to adequately consider the states' current troubles resulting from a lack of sales tax revenue. Admittedly, moving businesses overseas is not a desired outcome, but the same result—lost jobs—may be realized with the current rate of Internet sales growth and revenue loss due to use-tax leakage. Thousands of state employees depend on state revenues derived from sales taxes to fund their wages. As this tax base continues to erode through use tax leakage, jobs will also be lost, if only to a different fate—unemployment—rather than shifting bases of operation.

D. Increased Efforts to Collect the Use Tax

Although the SSTP is the most comprehensive proposal to address and rectify the loss in state tax revenue, its bold nature and dependence on a large number of states to comply with its mandate may slow its implementation. In the interim period, states have other options available to plug use tax leakage. Focusing on the fact that the current Internet tax dilemma is not a product of inadequate law, but rather inadequate compliance with the law, states can take steps to more actively enforce use tax laws.[234] The most obvious measure is to increase audits of taxpayers.[235] By examining an individual's spending behavior, the state taxing authority can determine whether purchases were made from a remote vendor that was not obligated to collect a sales tax. An audit would be able to discover whether the consumer self-reported the corresponding use tax on his or her individual return. This method, although effective, is extremely costly.[236] The amount of use tax evasion per consumer is likely a negligible amount that would be outweighed by the cost of training and deploying taxing agents to investigate the number of consumers necessary to regain substantial revenue.[237]

234. *See* Klima, *supra* note 7, at ¶ 15 (noting that "[s]tates have two options . . . to stop the sales tax leakage: (1) stronger enforcement of use taxes, or (2) give e-retailers an incentive to voluntarily collect and remit sales taxes"). The argument for inducing remote vendors to voluntarily collect and remit sales taxes usually involves the granting of amnesty to relieve remote vendors of a potential liability for back taxes, interest, and penalties for failing to collect and remit taxes that were required, but not paid. *See* Nathaniel T. Trelease, *Taxing Internet Sales: Bringing the Old Economy to the New Economy*, COLO. LAW., Dec. 2003, at 11, 13–14 (2003). In addition, shareholder litigation may arise alleging that the vendor's officers breached their duty of care by failing to correctly access the corporation's tax liability. *Id.*

235. Klima, *supra* note 7, at ¶ 16.

236. Swartz, *supra* note 6, at 144 ("[A] reliable and efficient auditing system simply would not be cost effective.").

237. Hart, *supra* note 4, at 400–01 (stating that enforcement of use tax compliance "would be burdensome to the point of futility").

More aggressive auditing would also be politically unwise and generate privacy concerns.[238] In addition, the time needed to sift through old receipts or credit card statements to determine if the proper tax was collected is disruptive to consumers (and more importantly for public officials, disruptive to voters).[239] Challenging the tax returns of a large number of state residents for a small dollar figure gain is not a practice consistent with long-term political success.

A less direct method of determining consumer compliance is through information-sharing between states.[240] For instance, a consumer who purchases furniture in Missouri and has it shipped to Illinois, where the vendor has no physical presence, may avoid paying Illinois sales tax. However, if the Missouri business submitted the purchase information to Illinois taxing authorities, the amount of use tax due could be determined and checked on the individual's return without an invasive audit.[241] Of course, an audit would result if the tax were not voluntarily remitted. This method again raises privacy concerns that businesses are sharing personal information about consumers. It may also invoke a federalism challenge if an out-of-state business without nexus with the taxing state were forced to act. Therefore, this type of information sharing may be restricted to a voluntary relationship. Authorities in Florida have reportedly found a way around this concern.[242] Florida police stop furniture trucks crossing the state border and examine the value of the goods and determine the purchaser.[243] The state waits the appropriate amount of time for the tax to be remitted, and if the purchaser does not self-report the proper use tax, he or she is billed for the amount plus interest and penalty.[244]

Another potential remedy focuses on evidence that much of the use tax leakage can be attributed to consumers who are unaware of their obligation. To combat consumer ignorance, a state advertising campaign should be used to educate consumers.[245] Advertisements would likely be most effective at changing consumer behavior if they are posted on Internet vendors' Web sites.[246]

In conjunction with an advertising campaign, states could use their own tax forms to raise consumer awareness.[247] Some states have experimented with

238. Klima, *supra* note 7, at ¶ 16; *see* Trelease, *supra* note 234, at 12.
239. *See* Trelease, *supra* note 234, at 12.
240. Klima, *supra* note 7, at ¶ 16.
241. *Id*.
242. *Id*.
243. *Id*.
244. *Id*.
245. Klima, *supra* note 7, at ¶ 16.
246. *Id.*
247. *See id*.

inserting a line on the front page of the individual tax form for use tax owed instead of providing the calculation in a separate schedule.[248] The line on the front page could include a brief set of calculations that asks the taxpayer to list the amount of purchases made in the absence of sales tax, which would be multiplied by the state use tax rate. In particular, Louisiana moved its use tax instructions to the front of its tax form and realized collections in a single year that were three times the amount received in the previous seven years.[249]

Another method of making taxpayers aware of their use tax obligation is to include on the individual tax return form a default use tax amount, based on a percentage of income. In this situation the taxpayer can no longer plead ignorance of the law. If the taxpayer wishes to escape the use tax burden, he or she must deliberately change the default number to zero. In addition to bringing the obligation to the taxpayer's attention, this method makes it easier to prove that a taxpayer knowingly engaged in tax evasion rather than inadvertently overlooked the obligation.

E. Sales Tax Deduction

A new federal tax law may work together with other potential solutions to mollify objections that individual consumers have against being forced to pay transaction taxes on remote purchases.[250] For the 2004 and 2005 tax years, income tax return filers had the option of deducting state and local income tax paid or the amount of state and local sales tax paid.[251] The state and local sales taxes include compensating use taxes paid, thereby allowing consumers to deduct taxes withheld on remote Internet purchases.[252] This deduction is really the resurrection of a former tax law that was eliminated in 1986.[253] The former tax law did not make consumers choose, but rather allowed a deduction for both income tax payments and payments for state and local sales taxes.[254] The Tax Reform Act of 1986 was a sweeping proposal with an aim at eliminating complexities that existed in a system with numerous itemized deductions.[255] The Tax Reform Act was written to eliminate all state and local tax deductions,

248. *See id*.

249. *Id*.

250. American Jobs Creation Act of 2004, Pub. L. No. 108–357, § 501, 118 Stat. 1418, 1520–21.

251. *Id*.; Internal Revenue Service, *Optional State Sales Tax Tables*, I.R.S. Publication 600 (2004), *available at* http://www.irs.gov/publications/p600/index.html [hereinafter IRS Pub. 600] (last visited Nov. 4, 2005).

252. American Jobs Creation Act of 2004 § 501; IRS Pub. 600, *supra* note 251.

253. Carole Keeton Strayhorn, *Restoration of the IRS Sales Tax Deduction Should Be One of Texas' Main Priorities in Congress*, Mar. 2002, http://www.window.state.tx.us/specialrpt/deduction04 [hereinafter *Restoration of Sales Tax Deduction*] (citing the passage of the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085).

254. *Id.*

255. *Id*.

but in compromise negotiations the only deduction eliminated was that of state and local sales taxes.[256]

One of the major objections to the elimination of a sales tax deduction was the inequity it caused to taxpayers.[257] Currently forty-two states and the District of Columbia impose a state income tax.[258] Residents of the eight states that remain are unable to take advantage of the deduction for income tax paid. The net effect of this geographic taxing disparity is that taxpayers in states without income tax pay more taxes to the federal government as a percentage of income than do residents of other states.[259] Enter the American Jobs Creation Act of 2004.[260] The majority of the American Jobs Creation Act is dedicated to business taxation; however, buried in the language is a congressional green light for consumers to deduct sales taxes on their federal returns.[261] It is important to note that this deduction is available only to the approximately one-third of taxpayers who itemize deductions rather than taking the standard deduction.[262]

As mentioned, the newest version of the sales tax deduction differs from the original in forcing taxpayers to make a choice between a sales tax or state income tax deduction.[263] For citizens in states without an income tax, the choice is obvious. The sales tax deduction is a boon to citizens of these states who will always be better off with the sales tax deduction.[264] For citizens of the other states, a comparison must be made.[265] To lighten the record-keeping burden on consumers, the U.S. Treasury has developed "State Sales Tax Tables."[266] The tables eliminate the need for consumers to retain receipts for every purchase made throughout the year, which would then be aggregated to determine sales taxes paid.[267] They are based on the average consumption by taxpayers, filing status, number of dependents, the amount of income earned and the state income tax rates.[268] Therefore, taxpayers in states with high

256. *Id*.

257. *Id*.

258. States without a current state income tax include: Alaska, Florida, Nevada, South Dakota, Tennessee, Texas, Washington, and Wyoming. Kay Bell, *State Sales Taxes Now Can Cut Your IRS Bill*, BANKRATE.COM, Dec. 17, 2004, http://www.bankrate.com/brm/itax/20041012b1.asp.

259. Strayhorn, *supra* note 253.

260. Pub. L. No. 108–357, § 501, 118 Stat. 1418, 1520–21.

261. *Id*.; Bell, *supra* note 258.

262. Bell, *supra* note 258.

263. American Jobs Creation Act of 2004 § 501; IRS Pub. 600, *supra* note 251.

264. Bell, *supra* note 258. Residents of Alaska, however, will be unable to take advantage of the sales tax deduction because Alaska does not impose a state sales tax. *See id*.

265. *Id*.

266. IRS Pub. 600, *supra* note 251, at 2–5.

267. *Id.* at 2.

268. Bell, *supra* note 258.

levels of income tax will receive higher deductions than taxpayers in lower-taxed states.[269] Similarly, the deduction increases as family size and total income rises, recognizing that as family size and income increases so do purchases and ultimately sales taxes paid.[270]

Consumers are not forced to rely on the deduction given in the table. They are free to save receipts and deduct the actual amount paid.[271] While this alternative will not be appealing to most taxpayers, an add-on provision to the tax tables will lead many consumers to deduct sales taxes rather than income taxes. The provision allows taxpayers to supplement the deductible amount given in the table by sales taxes paid on certain specified items, and it is also available to consumers who elect to take the standard deduction.[272] These items include most types of automobiles, aircrafts, boats, homes, and home building materials.[273] The sales tax paid on a car or on a new home can be substantial, and in 2004 and 2005, deductible. This allowance will go a long way in reducing consumer resistance to paying sales tax on large dollar-figure items such as purchases of home building materials that are purchased over the Internet from a remote vendor. The potential for increased consumer demand due to the deductibility of the sales tax will also help persuade remote vendors to collect sales taxes in the absence of a physical presence in the taxing state.

In certain instances the benefits of a sales tax deduction may be limited. For instance, if the sales tax rate charged is greater than the general state sales tax rate, the deduction will be limited to the general sales tax rate.[274] This may occur in states that assess a higher tax rate on some items, such as motor vehicles.[275] Situations also arise where the sales tax rate is lower than the general level. This is commonly found with food, clothing, and medical supplies.[276] If a sales tax is charged that is lower than the general rate, the deduction will be limited to the amount paid.[277] Variations in sales tax rates within a state would be less frequent if the uniform provisions of the SSUTA applied.

The effect of this new tax change and the number of consumers who will take advantage of it is currently unknown. What is clear is that this deduction

269. *See generally* IRS Pub. 600, *supra* note 251, at 3–5.

270. *Id*.

271. American Jobs Creation Act of 2004, Pub. L. No. 108–357, § 501, 118 Stat. 1418, 1520–21; IRS Pub. 600, *supra* note 251, at 2.

272. IRS Pub. 600, *supra* note 251, at 1; *see* Bell, *supra* note 258 (calling the add-on provision a "hybrid option" that allows consumers to claim the standard deduction and also receive the benefits of the sales tax deduction).

273. IRS Pub. 600, *supra* note 251, at 2–3.

274. *See* American Jobs Creation Act of 2004 § 501(F); *see also* IRS Pub. 600, *supra* note 258, at 1.

275. *See* IRS PUB. 600, *supra* note 251, at 1.

276. *Id*.

277. American Jobs Creation Act of 2004 § 501(C); IRS Pub. 600, *supra* note 251, at 1.

alone is not enough to change the course of the Internet taxing debate, although it should help pacify the individual consumer. Remote vendors and businesses purchasing supplies from these vendors will remain largely unaffected. While it is true that remote vendors should benefit from a degree of customer goodwill because of the knowledge that sales taxes would be deductible, the purchase of most routine items will not be large enough to justify the administrative cost of retaining each individual receipt. Therefore, most consumers will rely on the provided tax tables without recognizing a benefit from each additional purchase. Business purchases will likewise remain unaffected. In most cases, purchases for resale are sales tax exempt, bringing these purchases outside of the deduction, while other purchases for use in a business are not deductible.[278]

Both states with and without a sales tax in place should support this measure. A federal sales tax deduction acts as a federal subsidy to the states. The Congressional Budget Office has estimated the annual tax cost of a sales tax deduction at $2.0 billion.[279] This money is certainly not given to the states outright, but it may allow states to directly increase sales tax rates with fewer objections from their citizens. Alternatively, states may be able to lower state income taxes, thereby galvanizing citizen support, while simultaneously increasing sales tax rates enough to cover the loss from the reduction of income taxes and provide a net increase in revenues. Consumers would be willing to accept this trade off as long as the total amount of tax expense does not increase. This is made possible through the federal government-funded sales and use tax deduction.

VI. CONCLUSION

The problem created by use tax leakage cannot be ignored any longer. The majority ofstates understand the growing financial crisis created through untaxed remote Internet sales and have created a firm resolution. Instead of leaving the task of implementing a solution entirely to the states, Congress should enact legislation embracing the SSTP. In the interim period, states should adopt use tax awareness campaigns and push for the permanent approval of a sales and use tax deduction for consumer purchases. Taken as a whole, these measures will reduce the compliance burden on remote sellers, satisfy Commerce Clause and due process requirements, achieve tax policy objectives by treating all vendors equally, and reduce consumer resistance to change.

The Internet has changed the way the world transacts business and shares information. It has also unwittingly exacerbated consumer tax evasion.

278. *See* Morris, *supra* note 21, at 1395 (noting that “in practice, many business purchasers are subject to sales tax”).

279. *Restoration of Sales Tax Deduction*, *supra* note 253.

Undeniably, the Internet has sparked commerce and ingenuity, but in doing so, has cost states billions of dollars. To preserve the financial integrity of states, tax laws must keep pace with the evolution of business.

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