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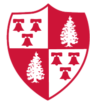

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Current Developing Trend of Sales Tax on E-Business

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ABSTRACT

This article explores the development of sales tax on e-business. It points out that the problem was rooted in the fact that the seller is required to collect and remit the tax to the buyer's state government. If the seller and the buyer do not reside in the same state, the buyer's state government has no jurisdiction over the seller, unless there is a "physical presence" of the seller in the buyer's state. A state government can require an out-of-state seller to collect sales tax from the in-state buyer only when there is "physical presence." However, what constitutes "physical presence" can become very controversial and complex. This article discusses many court cases. As Internet commerce was incorporated into the business operations, a great many transactions were executed online. The concept of "physical presence" became even more complex, as websites and digitized products became more commonplace. A new concept of "economic nexus" has evolved under many state statutes. Now an out-of-state seller may be required to collect sales tax from an in-state buyer, regardless of "physical presence." In 2013 the United States Senate enacted the "Marketplace Fairness Act of 2013." This embraced the concept of "economic nexus." This legislation could potentially end or at least greatly simplify all controversies in e-business taxation. This paper further notes that the concept of "economic nexus" may be extended to the arena of state income tax.

Keywords: Amazon Tax, E-Business, Economic Nexus, Marketplace Fairness Act of 2013, Physical Presence, Sales Tax, Streamlined Sales, Use Tax Agreement

INTRODUCTION

The volume of e-business sales is expected to grow from $259 billion in 2013 to $297 billion in 2014 with a growth rate of 15.7% per year and accounts for 6.4 percent of the total retail sales (The United States Department of Commerce, 2014). The sheer numbers are astounding and the trend is accelerating. Unfortunately, there is a growing tax problem related to this development. E-business entails sales tax just like any other business transactions. Sales tax has traditionally belonged to the jurisdiction of the state and local governments, but most of the online sellers reside outside of the state boundary of the purchaser. This makes it very

DOI: 10.4018/ijebr.2015040104

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difficult to collect sales tax from them. By recent estimate the sales tax revenue lost is $23 billion a year (Langley, 2012). The situation is becoming more serious recently only because of the tremendous growth of e-business volume. Where is the problem? The solution is extremely tumultuous. What is the current status now? The controversies involve the concepts of "physical presence" versus "economic nexus." It is further complicated by the legal aspects of the "Streamlined Sales and Use Tax Agreement" and the "Marketplace Fairness Act of 2013." This article investigates the evolution of sales tax in e-business and points to the trend of future development.

PROBLEMS OF SALES TAX IN INTERSTATE COMMERCE

The Commerce Clause of the Constitution of the United States granted sales tax to the state government to finance its operations, but it did not define a state's authority in collecting the tax (The United State Constitution.) Then the interstate commerce thrived. The sales tax immediately involved out-of-state sellers. Can the state government have the authority to collect sales tax from the sellers outside of the state of the purchaser? A problem is raised.

The Fourteenth Amendment in 1868 imposes a limit. It provides that ""No State shall make or enforce any law which shall abridge the privilege 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" (The United States Constitution Fourteenth Amendment).

The Amendment clearly prohibits the state government to collect sales tax from the sellers residing outside of the state boundary, unless there is a "due process" between a seller and the state. What is the "due process?" This is another problem.

"PHYSICAL PRESENCE" TO PAY SALES TAX

The "due process" has been interpreted to require a "nexus" or connection between the seller and the state. In other words, the seller has received government service from the state. In a sales transaction, if the buyer and the seller reside in the same state, it is the seller's responsibility to collect sales tax from the buyer and remit it to the buyer's state government, because there is a connection between the seller and the state. Thus, the minimum connection of the Due Process Clause and the substantial nexus of the Commerce Clause are clearly satisfied.

If the buyer and the seller do not reside in the same state it is the buyer's duty to remit the amount of sales tax to his/her own state government. This is known as "use tax." In this situation, the seller is not held responsible for collecting sales tax from the buyer, because there is no "nexus" or connection between the seller and the state. Hence, the "due process" is not satisfied.

For example, Susan, a New Jersey resident, is a garden lover. She bought flower seeds from the local Plouch Garden Center in New Jersey. She also bought vegetable seeds from Gardener Supply in Maine. How should Susan pay sales tax? Plouch should collect sales tax from Susan because Plouch has "physical presence" in New Jersey. However, Gardener Supply is not required to collect sales tax from Susan because Gardener Supply has no "physical presence" in New Jersey. Instead, Susan should voluntarily remit the due amount of "use tax" to her home state of New Jersey.

At the time the Commerce Clause was drafted the intent was to prevent the states from interfering with interstate commerce. It was easy to identify the location of the buyer and the seller, and if both resided in the same taxing jurisdiction there was no need for regulation by Congress. The interpretation requiring physical presence when buyer and seller were not in the same state made sense.

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Now, time and circumstances have changed. Today, many products can be digitized, such as software, e-books, e-games, e-music, etc. The product can be transferred from one computer to the other without knowing where the seller resides. Likewise, it may be difficult if not impossible to identify where the buyer resides. The concept of "physical presence" has encountered many problems in today's Internet age. Here are some of the issues.

Physical Presence of a Website

All digitized products can be purchased and sold on a website. What is the state residency of a website? For example, John designs a tennis-playing game and puts it on the website of http://www.yahoo.com/game for game lovers to play for a fee. Anyone who plays it pays $5 by credit card. Tom plays it and pays for it by using his Citibank credit card. Where does John reside? Likewise, where does Tom reside? It is probably impossible to know for certain. Without knowing whether John resides in the same state as does Tom, how can Tom decide whether he should pay sales tax to John directly or remit the "use tax" to his own state government? If John resides in a state other than Tom's state, Tom can legally refuse to pay sales tax to John directly. Reciprocally, John also can refuse to collect sales tax from Tom. If Tom ignores his use tax-paying responsibility, Tom's state government stands to lose the use tax revenue. . At a time when many state governments are strapped for cash and some face huge underfunded pension liabilities the loss of potential revenue is a major concern,

John's website is not registered in any state. It has no "physical presence" in any state. It exists only on the Internet. A website is not a person, but it acts like a seller. So, what is the state residency of a website? Can a website be construed as the state of residency of the seller? The situation becomes quite confusing. It shows that the existing physical presence concept now breaks down, because it is obsolete and out-of-date in a transaction on the website. Evidently, there is another problem.

Residency of a Computer Server

In order to determine the appropriate taxing authority, the concept of "physical presence" requires that we know the residence of both the buyer and the seller. In today's Internet business, the seller, more often than not, hires an IT company to design and process the customer's order, shipping, invoice and payment. The IT company offers services as a computer server, but it is not the real seller. The server may be located outside of the real seller's state of residence. Worse yet, a computer server is portable. The computer server does maintain a residence somewhere, but it can be moved around to anywhere. Can the computer server be construed as the state residency in collecting sales tax? The concept of "physical presence" does not work well with a moveable residence. The residency requirement now encounters another problem.

This actual issue was raised in Virginia in 2000. An out-of-state auto parts manufacturer hired a computer company in Virginia to serve as a server to process all aspects of business transactions, such as billing and payment. This computer company asked the Virginia Tax Commissioner whether its server in Virginia would trigger "nexus" and thus it would be required to collect sales tax from the buyers. The Commissioner ruled negative on the basis of Code of Virginia §58.1-612 and Rulings of the Tax Commissioner 00-53 which provides that "The department does not deem nexus to exist for an out-of-state seller whose only presence in Virginia is the use of a computer server to create or maintain a site on the Internet. Accordingly, nexus will not be established for out-of-state vendors whose only presence is the use of computer servers provided to them under a Virginia managed hosting service" (Code of Virginia). Therefore, this computer company is considered to have no "physical presence" in Virginia and thus is not required to collect sales tax from any buyers.

Other states, for example California, have similar legislation. Its Revenue and Taxation Code Article 17, §6203 and Regulation 1684(b)

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(3) provide that "The use of a computer server on the Internet to create or maintain a World Wide Web page or site by an out-of-state retailer will not be considered a factor in determining whether the retailer has nexus with California. No Internet Service Provider, On-line Service Provider, internetwork communication service provider, or other Internet access service provider, or World Wide Web hosting services shall be deemed the agent or representative of any out-of-state retailer as a result of the service provider maintaining or taking order via a web page or site on a computer server that is physically located in this state" (California Revenue and Taxation Code). This means that a computer server in California (with no other contact with the state) is not construed as having "physical presence" in the state.

Similar tax law is also provided in Minnesota Sales Tax Guide §60-445 (Minnesota Sales Tax Guide) and Texas Tax Code Title 2, Section 151.108 (Texas Tax Code). It now becomes clear that the so-called "physical presence" does not include a computer server. As such, a company operating a computer server is not required to collect sales tax from a buyer.

The above examples demonstrate that the traditional concept of "physical presence" requires the information of state residency. In today's Internet age this information is elusive. As a result, this concept now becomes infeasible.

COURT CASES FOR "PHYSICAL PRESENCE"

In the past the concept of "physical presence," did not operate in practice without problems. Exactly what constitutes "physical presence?" The following court cases demonstrate the practical problems that can arise in attempting to answer this question and suggest ways from which one can derive a guiding principle in deciding whether "physical presence" exists between an out-of-state seller and the state.

Mail Order

In 1941 Sears, Roebuck & Co. was a mail order company with headquarters in New York. However, it maintains a branch in Iowa. Some of the customers in Iowa sent mail order to the headquarters through the branch office, while others sent orders directly to headquarters. Sears collected sales tax from the former, but not the latter. The State of Iowa filed a lawsuit against Sears for the latter. Should the branch office constitute "physical presence" for orders sent directly to an out-of-state headquarters? The U.S. Supreme Court ruled in favor of Iowa (The Supreme Court of the United States, 1941). Hence, Sears was required to collect sales tax from the customers who sent mail orders directly to the headquarters. This means that an office in Iowa constitutes "physical presence," for sales to Iowa residents regardless of where the mail orders come from.

Salesmen

In 1944 General Trading Company in Minnesota sent travelling salesmen to Iowa to sell products. General Trading did not maintain an office in Iowa and thus did not collect sales tax from customers in Iowa. The state of Iowa filed a lawsuit against General Trading. The Supreme Court of the United States ruled it in favor of Iowa (The Supreme Court of the United States 1944). This case demonstrates that having salesmen in a state is sufficient to constitute "physical presence" in that state.

Delivery Truck

In 1954 Miller Brother Company was located in Maryland. Some customers came to shop from the neighboring state of Delaware. If the merchandise was too heavy Miller would use its delivery truck to deliver the merchandise to Delaware. However, Miller did not collect sales tax from customers in Delaware on the grounds that a delivery truck should not constitute "physical presence" in Delaware. The

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State of Maryland confiscated Miller's truck when it entered into Maryland. Miller filed a lawsuit against Maryland. The Supreme Court of the United States ruled in favor of Miller (The Supreme Court of the United States 1954). Hence, Miller was not required to collect sales tax from customers in Delaware. This case demonstrates that a delivery truck did not constitute "physical presence."

Independent Contractor

In 1960 Scripto, Inc. in Georgia hired independent contractors to sell its stationery products in Florida. Scripto did not collect sales tax from customers in Florida on the basis that independent contractors were not regular employees and therefore the General Trading Company result was not applicable in this case. The State of Florida filed a lawsuit against Scripto. The Supreme Court of the United States ruled in favor of Florida (The Supreme Court of the United States, 1960) indicating that independent contractors will also constitute physical presence within a state. Initially this may seem inconsistent with the decision in Miller, but perhaps this can be explained by the fact that in Miller there was only an occasional delivery activity into Delaware, whereas in Scripto the activity of the independent contractors was consistent and substantial.

Computer Software

In 1992 Quill was an office products company in Delaware. It sent catalogs and computer software to customers in North Dakoda for the purposes of placing orders, but Quill did not collect sales tax from these customers on the basis that computer software was not an employee and therefore the General Trading principle did not apply as the software should not constitute "physical presence" in North Dakota. The State of North Dakoda filed a lawsuit against Quill. The Supreme Court of the United States ruled in favor of Quill (The Supreme Court of the United States 1992). As a result, Quill was not required to collect sales tax from customers in North Dakota. This case sets the rule that computer software in a state does not constitute "physical presence" in that state.

The above court cases give some guidance as to what constitutes "physical presence" and what does not. In today's Internet age many buyers and sellers do not have the same state residency, for example sales through a website. The seller has no "physical presence" in a state. It becomes a loophole for an out-of-state seller to argue that there is no "physical presence," and thus it is not required to collect sales tax. This dilemma points to the faulty concept of "physical presence." The next section explores how the state governments have attempted to react by enacting legislation to mandate an out-of-state seller to collect sales from the in-state buyer.

"ECONOMIC NEXUS" TO COLLECT SALES TAX

Given the fact that states have physical borders and the ability to enact their own state-specific legislation the Commerce Clause of the U.S. Constitution is necessary to prohibit discrimination in interstate commerce. For example, if milk produced in the home state is not taxed, the milk produced in another state and sold in the home state should also not be taxed. The same principle applies to the sellers in other states. A seller is a person, not merchandise. An in-state buyer is required to pay sales tax only because this person receives government services from the state, such as highways, schools, hospitals, etc. An out-of-state seller does not receive the same services. The argument then is that this person should not be required to bear the same burden as does the in-state buyer. The concept of "physical presence" was established to protect the out-of-state sellers from taxation without representation.

Today, the concept of state borders is less clear. A salesman can travel in all fifty states. This salesman may reside in one state but receive government services or benefits from all states that he or she may visit. Merchandise is sold throughout all fifty states. A corporation resides in one state but derives profit from all

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states. Internet commerce now replaces the traditional brick-and-mortar store. As we discussed above, what is the state residency of a website? Software can be transferred from one computer to another by e-mail. Where is the seller and where is the buyer? These questions are not always easy to answer.

Under these new business operating environments, the concept of state border disappears. The requirement to identify the state residency becomes infeasible. The basis to pay sales tax is no longer where the taxpayer resides, but where the profits or benefits were derived. As long as the seller has derived profits, directly or indirectly, from a state, it is required to collect sales tax from the in-state buyer, regardless of whether there is "physical presence" in that state. This is known as "economic nexus." Many states have enacted tax law to apply this concept. The next section describes the current status of the new tax law.

COURT CASES FOR "ECONOMIC NEXUS"

The traditional concept of "physical presence," that governs the current sales tax law, has caused the state governments to lose a tremendous amount of sales tax revenue. In an attempt to remedy the deficiency the new tax law on the basis of "economic nexus" was initiated in 2008 in New York State. Because Amazon was the poster child for taxpayers which made sales into a jurisdiction where they had no physical presence and therefore did not collect sales tax the law came to be known as the "Amazon Tax." These taxes are a direct challenge to the decisions of the U.S. Supreme Court, especially the Quill decision.

Since the enactment in New York, eighteen states have enacted similar tax laws. They are Arkansas, California, Colorado, Connecticut, Florida, Kentucky, Illinois, Missouri, New Jersey, New York, Nevada, North Carolina, Ohio, Pennsylvania, South Carolina, Texas, Tennessee and Virginia (Amazon Tax, 2014). Notwithstanding its popularity, the law is subject to legal challenge in the courts. Here are some of the major cases.

New York

In 2008 the New York State legislature enacted the so-called "Amazon Tax" law." It provides that the online seller is required to collect sales tax from purchasers in New York State if "The seller enters into an agreement or agreements with a New York State resident or residents under which, for a commission or other consideration, the resident representative directly or indirectly refers potential customers to the seller, whether by link on an Internet Web site or otherwise. A resident representative would be indirectly referring potential customers to the seller where, for example, the resident representative refers potential customers to its own Web site, or to another party's Web site which then directs the potential customer to the seller's web site," and "The cumulative gross receipts from sales by the seller to customers in New York State as a result of referrals to the seller by all of the seller's resident representatives under the type of contract or agreement described above total more than $10,000 during the preceding four quarterly sales tax period." (New York Department of Taxation and Finance, 2008)

This new tax statute means that an online seller, who engages a New York resident to sell products through a website connection, where the seller's sales total $10,000 or more for any prior 12 month period, is required to collect sales tax from the in-state buyer, even though the seller has no physical presence in New York State. This New York resident is referred to as "affiliate." The "affiliate" is treated as an "independent contractor" similar to the case of Scripto v. Carson. This tax law is a direct challenge to all the United States Supreme Court decisions that require "physical presence" of the seller in the state so as to hold the seller responsible for collecting sales tax.

For example, assume McGraw-Hill Publishing Company and Prentice-Hall Publishing Company are located physically outside of New York state. Both have no branches in

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New York. New York University is located in New York. However, McGraw-Hill signed a contract with the New York University Book Store to put McGraw-Hill's website address on the website of the New York University Book Store so as to enable the students to order books online; whereas, Prentice-Hall did not sign the contract. A student orders a book online from McGraw-Hill and another book also online from Prentice-Hall. Are these two publishing companies required to collect sales tax from this student? The answer is affirmative for McGraw-Hill because it has an "affiliate" in New York State under the "Amazon Tax" law, but negative for Prentice-Hall because it has no 'affiliate" and thus the "Amazon Tax" law does not apply.

This example shows the impact of the "Amazon Tax Law." Although McGraw-Hill has no "physical presence" in New York State, it has an "affiliate" in the state. As a consequence, the "affiliate" construes "physical presence" under the "Amazon Tax Law."

Upon enactment of the law, Amazon.com and overstock.com immediately filed a lawsuit against the New York State Department of Taxation and Finance in the Appeal Court of the State of New York, contending that the website is just a common practice in today's business. The "affiliate" is not intended to be an independent contractor. It should not be construed as "physical presence." On November 4, 2010 the court ruled in favor of the New York State Department of Taxation and Finance (The Appellate Court of the State of New York, 2010). It means that the Amazon.com as an out-of-state seller is required to collect sales tax from the in-state buyer. Amazon.com and overstock.com both immediately appealed the case to the Supreme Court of the United States. The decision will be described later.

Not every state has the same "Amazon Tax" law, as mentioned above. Nonetheless, as of today, Amazon.com still voluntarily collects sales tax from the following twenty-two states: Arizona, California, Connecticut, Florida, Georgia, Indiana, Kansas, Kentucky, Maryland, Massachusetts, Nevada, New Jersey, New York, North Carolina, North Dakota, Pennsylvania, Tennessee, Texas, Virginia, Washington, West Virginia, and Wisconsin (Amazon Tax, 2014).

Actually, the true underlying concept of the "Amazon Tax" law is really not the matter of "physical presence." Instead, it is the notion of "economic nexus." As long an out-state seller derives economic profit from a state, it has received benefits from the state. It should be treated in the same way as an in-state buyer who receives government services from the state. An out-of-state seller must also be required to pay sales tax. This concept of "economic nexus" has been becoming the new developing trend in sales tax on e-business today.

Illinois

Similar to the New York's "Amazon Tax" law, on March 10, 2011 the Illinois General Assembly enacted Public Act 096-1544. It provides that "1.1. Beginning July 1, 2011, a retailer having a contract with a person located in this State under which the person, for a commission or other consideration based upon the sale of tangible personal property by the retailer, directly or indirectly refers potential customers to the retailer by a link on the person's Internet website.

The provisions of this paragraph 1.1 shall apply only if the cumulative gross receipts from sales of tangible personal property by the retailer to customers who are referred to the retailer by all persons in this State under such contracts exceed $10,000 during the preceding 4 quarterly periods ending on the last day of March, June, September, and December" (Illinois Public Act, 2011).

This Illinois tax statute was almost identical to the New York's "Amazon Tax" law. It still refers to the situation where an in-state "affiliate" provides its website connection with the out-of-state seller for a sales revenue exceeding $10,000 a year. In that case, the out-of-state seller is required to collect use tax from the in-state buyer.

Performance Marketing Association immediately filed a lawsuit against the Illinois Department of Revenue in the Circuit Court of

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Cook County Supreme Court of Illinois. That court held against the state both on the basis that the sellers lacked the necessary nexus under the Commerce Clause, and were expressly preempted by the Internet Tax Freedom Act of 1998 (The Internet Tax Freedom Act, 1998), which prohibits "discriminatory taxes on electronic commerce." On October 18, 2013 on appeal the Illinois Supreme Court ruled against the state on the basis that the Illinois statute was discriminatory in violation of the Internet Tax Freedom Act because the tax applied to out-of-state sellers but not to traditional advertising by in-state retailers. The Court did not reach a decision on whether the Commerce Clause had been violated. Therefore an out-of-state seller is not required to collect sales tax from the in-state buyer. This is a direct contradiction to the result reached by the New York State Appeals Court but the result was reached for a different reason. The subject of "Amazon Tax" now becomes more controversial. In fact, there are more controversies. It will involve the state government's request for an in-state buyer's information from the out-of-state seller, as will be explained below.

North Carolina

Having failed to compel out-of-state sellers to collect sales tax from in-state buyers, the state governments now turned their attention to in-state buyers to compel them to pay the use tax and if necessary have the out-of-state sellers provide the states with information about the in-state buyers. On December 1, 2009 the North Carolina Department of Revenue requested Amazon to provide all information on any sales to residents in North Carolina, including the buyer's name and address. The purpose is to enable the state government to inform the buyer's duty to pay "use tax." Amazon gave a customer's city, order number and products catalogue, but not a customer's name, address, telephone number and e-mail.

Not surprisingly the Department was not completely satisfied and threatened to revoke Amazon's business permit in North Carolina. Amazon and The American Civil Liberties Union (an unlikely ally of Amazon) filed a lawsuit against North Carolina in the United States District Court West District of Washington (Amazon's home state) on the ground that the request violated the First Amendment of the Constitution of the United States protecting the privacy of a citizen's purchase on books, music and audiovisual materials. They argued that the request further violated the Video Privacy Protection Act that prohibits disclosure of personal identifiable information (The United States Code, 18).

On October 25, 2010 the court ruled in favor of Amazon (The United States District Court Western District of Washington, 2010). It means an out-of-state seller is not required to supply the state governments with a customer's personal information. This result renders a serious setback to the state governments. In fact, the state governments still did not give up. The struggles continue, as the case of Colorado below.

Colorado

Having seen the failure of other states to require collection of sales or use tax the state of Colorado tried a different approach. The state government now tried to shift the "use tax" collecting enforcement (as opposed to collection) duty to the out-o-state seller. On March 1, 2010 the House of the State of Colorado enacted a statute that requires an out-of-state seller to submit a report to the Colorado Department of Revenue detailing all information about sales of product to residents in Colorado, such as the nature of the product, amount of sales, the buyer's name and address, etc. The statute further required the out-of-state sellers to inform the in-state buyers of their duties to file a report for the payment of "use tax" (The State of Colorado, 2010). Beyond the situation in North Carolina, the Colorado statute required a seller to act like a tax enforcer.

On August 13, 2010 the Direct Marketing Association filed a lawsuit against the Colorado Department of Revenue in the United States

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District Court for the District of Colorado on the claim that the Colorado statutes not only violated the constitutional right of privacy. It also argued that the statute discriminated against interstate commerce, and violated the Commerce Clause and the Due Process Clause. On March 30, 2012 the Federal District Court issued a permanent injunction against the state from enforcing the notice and reporting provisions of the law.

Colorado appealed the case to the 10th Circuit Court of Appeals which dodged the substantive issue by ruling that the District Court had violated the Tax Injunction Act which prohibits a Federal District Court from enjoining, suspending or restraining "the assessment, levy or collection of any tax under State tax law where a plain, speedy and efficient remedy may be in the courts of such state" (28 U.S.C. 1341). The case was remanded to the District Court with orders to lift the injunction. The Direct Marketing Association appealed to the U. S. Supreme Court. On July 1, 2014 the Supreme Court granted certiorari and agreed to decide whether the 10th Circuit decision was correct. Thus the status of the Colorado statute is still in limbo. The Colorado case may imply that the concept of "physical presence" starts to crack. This is the new direction of development.

Below we discuss the Federal "Marketplace Fairness Act of 2013" which has not yet been enacted at the Federal level. Operating on a parallel attack against Direct Marketing Colorado has, in advance of the anticipated passage of that Federal Act, enacted legislation which will enable it to require collection of sales tax by out-of-state venders if the Marketplace Fairness Act becomes law.

THE MOST RECENT U.S. SUPREME COURT DECISION

It should be noted that, in the midst of the lawsuits back and forth between the out-of-state sellers and the state governments, the case of Amazon v. New York State Department of Taxation and Finance was still pending in the U.S. Supreme Court. At that time Amazon argued that:

Amazon had no physical presence – no real estate, employees, or sales agent – in New York, and it therefore indisputably lacks a substantial nexus with the State. It has only website advertising affiliates and their in-state activities in Amazon's behest do not create a substantial nexus. Indeed, the physical location of Amazon associates is irrelevant and unknown to Internet consumers. Those websites can draw "hits" from anywhere, and there is nothing New York-centric about such advertising posting. (Supreme Court of the State of New York, 2008)

The essence of the argument is still centered on the meaning of "physical presence." Amazon contended that the so-called affiliates in New York serving as website link are not employees or independent contractors. The website is intended to be an "advertising channel." It should not be construed as a "physical presence." As such, there is no nexus between Amazon and New York State.

The New York Court of Appeals in a 4 to 1 decision issued in 2010 ruled in favor of the New York Department of Taxation and Finance (The Supreme Court, Appellate Division, State of New York, 2010). As long as an out-of-state seller receives economic benefits from New York State, the seller is required to collect sales tax from the in-state buyer, even though the seller has no physical presence in the state. In other words "economic nexus" would override "physical presence."

At that point the question of whether a state government could require an out-of-state seller to collect sales tax from an in-state buyer without 'physical presence was answered in the affirmative in New York, but in the negative in Illinois, North Carolina and Colorado.

Amazon appealed the New York State Appeals Court decision to the U.S. Supreme Court, but on December 2, 2013 the Supreme

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Court ruled to deny the petition by Amazon.com, LLC, et al., Petitioners (The Supreme Court of the United States, 2013). The Supreme Court gave no reason for its decision. It means that in a state with an Amazon type tax an out-of-state seller is required to collect sales tax from the in-state buyer, even though the seller has no "physical presence" in the state.

This court ruling implies many aspects. As long as an out-of-state seller receives economic benefits from the state the seller is, in substance, construed to have nexus with the state. This is the concept of so-called "economic nexus." In essence, this ruling has literally changed the requirement for an out-state seller to collect sales tax from the in-state buyer from "physical presence" to "economic nexus." This ruling may also imply that an affiliate in the state to serve as a website link is construed to be either an employer or an independent contractor. As such, there is a "physical presence." This ruling may further imply that the tumultuous arguments between "physical presence" and "economic nexus" in the past six decades finally come to an end, and the latter is declared to be the winner.

It now becomes clear that the developing trend of internet commerce taxation has been evolving from "physical presence" to "economic nexus." Those who have "physical presence" must have "economic nexus." However, those who have "economic nexus" may not have "physical presence." If "economic nexus" is becoming the current prevailing criteria in determining whether an out-of-state seller is required to collect sales tax from the in-state buyer, the "physical presence" has thus become irrelevant. In other words, any online seller who sells a product to a buyer in the state, regardless of whether the seller is located in the state or outside of the state, is now responsible for collecting sales tax.

In fact, there is another new development that can substantiate the above trend of evolution from "physical presence" to "economic nexus." This is the "Marketplace Fairness Act of 2013," as will be explained below.

THE "MARKETPLACE FAIRNESS ACT OF 2013"

In many court rulings mentioned above, the most frequently cited case was the case of Quill v. North Dakoda where the seller from Delaware had no employee or branch in the state. As a result, the seller was not required to collect sales tax from the buyers in that state. That decision was rooted in the concept of "physical presence" as stipulated in the Fourteenth Amendment of the United States Constitution. This ruling further stated that this criterion cannot be changed without legislation by the United States Congress. The legislation may indeed be enacted but it is not certain of passage.

On May 6, 2013 the United States Senate passed the "Marketplace Fairness Act of 2013" (The Act) (Marketplace Fairness Act, 2013). The Act has not yet been passed by the House of Representatives, so it is not yet law and there is some doubt that the Republicans who control the House will ultimately pass the bill. If enacted The Act grants state governments authority to collect sales and use tax from remote out-of-state sellers, especially those who have no "physical presence" in the state. It is presumably aimed at Internet commerce online sellers. However, The Act requires the state government to be a member of the so-called "Streamlined Sales and Use Tax Agreement" (SSUTA). The Act provides that "Each Member State under the Streamlined Sales and Use Tax Agreement is authorized to require all sellers…to collect and remit sales and use taxes with respect to remote sales sourced to that Member State…" (Marketplace Fairness Act, 2013, Section 2(a)). This means that the state governments can require any out-of-state seller to collect sales and use tax from the in-state buyer, without citing "physical presence." What is SSUTA?

Member States: Streamlined Sales and Use Tax Agreement

At present sales tax administration is a nightmare. Sellers are required to collect and remit

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sales and use tax to the buyer's state and local governments. There are 9,646 different state and local government units. Each unit potentially has a different tax base and different tax rate. The tax administration task is almost insurmountable. This difficulty discourages sellers from collecting the tax. In order to simplify matters, on November 12, 2002 forty-four states entered into the SSUTA. In order to benefit from the ACT each state government is required to implement the following steps (Streamlined Sales and Use Tax Agreement, 2002):

1. Each state must set up only one single tax administration agency for the seller to deal with;
2. Each state must have only one rule for determining the tax base. That is, what merchandise is taxable and what is nontaxable;
3. Each state must have only one sales tax rate;
4. Each state must have only one sourcing rule. It should be noted that merchandise can be sold to an in-state or an out-of-state buyer. The in-state buyer is charged at an in-state tax rate, while the out-of-state buyer at out-of-state rate. What constitutes in-state or out-state transaction. The state must stipulate only one rule so that it is easier for the seller to follow.

Nonmember States: Administrative Requirements

Currently there are only twenty-four (24) states that are member of SSUTA. What if the state is not a member of SSUTA? The Act would extend the benefit of allowing states to require out-of-state sellers to collect sales tax in the same way as a member state of SSUTA as long as the following requirements are met:

1. Each state must set up only one single tax administration agency for the seller to deal with;
2. Each state must have only one rule for determining the tax base. That is, what merchandise is taxable and what is nontaxable;
3. Each state must have only one sales tax rate;
4. Each state must have only one sourcing rule;
5. Each state must provide free sales tax administration software for the seller to use;
6. Each state must enact a law to relieve the seller of any liability caused by the errors of the software or the state.

The purpose of SSUTA is to simplify the task of sales and use tax administration. Whether a state is a member of SSUT or not must meet the same requirements so as to reach the same goal.

THE EVOLUTION OF THE SALES TAX

Looking throughout the entire history of development of sales tax it is quite intriguing to observe that the guiding principle has been evolving in the past six decades in response to the change in business operating environment. The sales tax problem was deeply rooted on the constitutional mandate that the sales tax was granted to the state government, but the buyers are moving from local to international and the products are innovating from physical to electronic. The legal aspect of the sales tax is progressing much slower than industrial technology. Both sides do not match. The disparity has caused a great many disputes in court cases.

Before the 1940's the sales activities were mostly in the same state. The sellers collected sales tax from buyer and remitted it to the state government. Thereafter, the mail order business started to develop, mainly from Sears & Roebuck and Montgomery Ward. The mail order business was quickly expanded to other states. The question arose "Could a state government collect sales tax from a buyer in other states?" The aspect of "interstate commerce" was born. The answer was negative because the tax jurisdiction of one state cannot reach the other. If so, it amounts to "taxation without representation." In order to do so, it requires

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"due process" between the buyer and the state. The concept of "physical presence" was then established. This meant the state government could not require a buyer in another state to pay tax, unless the taxpayer had employees or a branch in that state. The requirement of "physical presence" has been the guiding principles throughout a long period between 1950's and 1980's. However, what constitutes "physical presence" can be very controversial and tumultuous. As a consequence, at least a dozen cases went to the Supreme Court of the United States for rulings.

By the 1990's computers started to dominate interstate commerce. The nature of a product was revolutionized. Many products could now be digitized, such as e-books, e-journals, word processor, etc. In the past the tax law stated that only the personal tangible products were subject to sales tax. Examples included books and journals on papers, music on CDs, games on video, etc. Is an e-book a tangible or intangible product? The former is taxable while the latter is not. The computer age has complicated the taxability of a product. In fact, an e-book is just a computer version of a regular book on paper. A new concept of product, called "digitized product," was now created in the computer world. Unfortunately, the tax law did not keep pace with the current products.

By the 2000's the Internet connection came into common use. This completely changed the business operation environment. All transactions are executed online on the Internet. The most devastating impact on the collection of sales tax was the fact that the sellers disappeared from the brick-and-mortar stores on main street. Instead, they went to their websites on the Internet. Nowadays, Internet commerce is borderless. What is an Internet store's address? More importantly, what is its state residency? Without knowing this information how can the state government exercise its taxing authority? The tax law is so much lagging behind the current Internet operation that the state residency problem will continue to exist. The state governments have lost an astronomical amount of sales tax revenue.

By the 2010's many state governments could no longer wait for the federal government to act. Instead, they started taking the matter to their own hands by enacting their own state tax law that all online sellers who sell products to the state were required to collect sales tax from the in-state buyer, regardless of the seller's state residency. A new concept, known as "economic nexus," was now introduced to the arena of sales tax. The new state sales tax law now does away with the problem of state residency as created by the Internet age.

By 2013 the United States Congress finally began to address its duty to enact the new "Marketplace Fairness Act of 2013." This would grant authority to the state governments to collect sales tax from the remote sellers, regardless of their state residencies as long as the states agreed to simplify the administration and collection of the tax. This means that The Act has finally abandoned the old requirement of "physical presence" and embraced the new concept of "economic nexus." In other words, The Act would literally end all arguments in the past and rendered all lawsuits to rest in the future. It has created a far-reaching impact on the aspect of Internet commerce taxation.

CONCLUSION

This article scans through the entire history of sales tax so as to derive any guiding principle from the past and identify any emerging trend in the future. It points out that the sales tax is borne by the buyer, but the taxing authority is given to the state government. The problem is who should collect and remit the tax to the state government - the buyer or the seller.

The problem was simple in the old days when the commerce was local. If the buyer and seller reside in the same state it was the seller's responsibility to collect the sales tax; if not, it was the buyer's duty to do so. When the commerce was extended to other states the sales tax collecting responsibility started to become an issue, because the state government has no jurisdiction over a seller in other state.

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This article traced back to the Constitution of the United States and pointed out the concept of "physical presence" as the requirement for a state government to demand an out-of-state seller to collect sales tax from the in-state buyer. Unfortunately, the requirement of "physical presence" was not well defined. As a result, many cases went to the court for rulings. This paper cited some of these cases, such as mail order, salesman, independent contractor, delivery truck, computer software, etc.

When the computer age set in the problem of "physical presence" became even worse. A great many transactions were executed online on the website. A website has no "physical presence" and thus lost its state residency. Many out-of-state sellers refuse to collect sales tax from the in-state buyers by claiming lack of "physical presence." As a consequence, the state governments lost a huge amount of sales tax revenue. This paper points out that the requirement of "physical presence" may no long be workable.

At this point of time the state governments started enacting their own laws to require all out-of-state sellers to collect sales tax from the in-state buyers, regardless of whether there is "physical presence" in that state. Any seller, who sells a product to the state on line or not, is held responsible for collecting the sales tax from the buyer. A new concept of "economic nexus" was born. This paper cited New York, Illinois, North Carolina and Colorado as examples.

Finally, the United States Senate is attempting to enact the so-called "Marketplace Fairness Act of 2013" that grants the state governments the authority to require all out-of-state sellers to collect sales tax from the in-state buyers. This legislation could potentially end all arguments about sales tax collecting responsibilities. Therefore, the current prevailing concept is "economic nexus." The most recent court decision by the Supreme Court of the United States also embraces this concept.

In the next phase of development, the concept of "economic nexus" will be extended to the arena of state income tax. Any out-state business entity that derives economic benefits from the state will be subject to state income tax, regardless of whether or not it has "physical presence" in that state. Some states have already done so and the trend would appear to be in this direction. This aspect would totally revolutionize the concept of state taxation. Another article would be required to develop this concept further.

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