

# Taxes On Remote Sales

## Election Brief

The Kem C. Gardner Policy Institute in Spring 2016 convened focus groups to identify important issues in the 2016 election. Taxes on remote sales was identified as an important topic by focus group participants. This Election Brief provides a concise analysis of the issues associated with remote sales so that voters, candidates, and, ultimately, elected officials can make informed decisions.

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### Summary

Americans are making more and more of their purchases online. Since 2000, the share of retail sales taking place online has grown almost ten fold. Yet, not all online retailers are required to collect taxes and only a small percentage of individuals report online sales in their annual tax filings.

Quantifying the amount of state and local taxes that go uncollected is difficult. The National Conference of State Legislatures estimates that uncollected taxes on remote sales

across the country totaled more than \$23 billion in 2012. The Utah Office of the Legislative Fiscal Analyst estimated the uncollected taxes in fiscal year 2016 totaled approximately \$230 million.

This election brief examines the complexity of online sales, including the legal context and the growth of online sales, and provides some policy options for consideration.

# INFORMED DECISIONS | 2016

The Kem C. Gardner Policy Institute and Hinckley Institute of Politics, in partnership with the Deseret News and KSL, are pleased to present INFORMED DECISIONS 2016, a series of election products and events that will help voters make informed choices in 2016.

This year promises to be a banner election year in Utah. The state will elect a governor, four U.S. congressmen/women, a U.S. senator, and nearly 90 percent of the Utah Legislature, as well as many other state and local officials. INFORMED DECISIONS 2016 will help voters navigate this important election year with analysis of critical issues impacting our state. It will also provide candidates with an opportunity to explain their views on these and other issues.

## Major components of INFORMED DECISIONS 2016

### Focus Groups

The Gardner Policy Institute convened focus groups drawn from the general public and issue experts in urban and rural Utah to identify important issues and potential policy options. These snapshots provide a summary of the focus group discussions.

### Election Briefs

Analysts from the Gardner Policy Institute, Hinckley Institute, and the Utah Education Policy Center have prepared policy briefs on the major issues identified in the focus groups. These briefs include information on why the issue is important, an analysis of key topics, and potential policy options for consideration. Election Briefs will be released in Fall 2016.

### Candidate Conversations

The Hinckley Institute, in collaboration with our media partners at the Deseret News and KSL, will lead a series of Candidate Conversations on targeted races. These forums will be hosted "town-hall style," similar to the CNN Town Hall format hosted by Anderson Cooper in the presidential elections. The Candidate Conversations will be held at the Gardner Policy Institute and the Hinckley Institute prior to the primary election. Later conversations will follow in October 2016.

# Election Brief

Between 2000 and 2015, Utah's population grew more than 33 percent and both state gross domestic product and total personal income, adjusted for inflation, grew more than 50 percent. Utah's annual combined personal and corporate income tax collections, adjusted for inflation, mirrored demographic and economic growth over this period, growing approximately 40 percent. Inflation-adjusted annual state sales and use tax collections, however, increased only 14 percent.<sup>1</sup>

In Utah, like in many states, sales and use tax collections are a major source of government revenue, accounting for about 25 percent of all combined state and local tax revenues.<sup>2</sup> When economic and demographic growth outpace revenue growth, public officials look for ways that government can be more efficient. Where government is already efficient, policymakers face tradeoffs between reducing services and raising additional revenue through tax increases.

One of the factors limiting growth in sales and use tax collections is an increasing share of online sales, on which many retailers are not required to collect taxes.<sup>3</sup> This issue brief examines the collection of taxes on remote sales – discussing both the current state of policy governing collection and proposals under consideration at the state and federal levels.

## Legal Context

In the 1992 *Quill Corp. v. North Dakota* case, the Supreme Court ruled that, while states may impose a sales and use tax on purchases made from out-of-state businesses, they may not require those businesses to collect and remit taxes.<sup>4</sup> The case stemmed from the North Dakota Tax Commission's attempt to collect use taxes on the sale of items shipped into the state by Quill, a Delaware-based office supply company.<sup>5</sup> The Court's ruling holds that a seller must have a substantial connection, or nexus, to the state through physical presence to be required to collect sales or use taxes. In its opinion, the Court pointed out that Congress has the authority to identify some standard of substantial connection other than physical presence for states to require the collection of sales and use taxes.<sup>6</sup>

The Quill ruling does not prohibit states from imposing a tax on purchases made from out-of-state businesses, rather it clarifies whether a state can require a business to collect such taxes. Utah, like other states with a sales and use tax, requires taxpayers to remit a use tax on their individual income tax returns when a sales tax is due but not collected by a seller.<sup>7</sup>

Compliance with this requirement is extremely low – less than 14,000 Utah taxpayers, just one percent of total taxpayers, disclosed a use tax liability on their 2014 state income tax return. The total amount remitted for this year was less than \$1 million, less than 0.5 percent of estimated total liability.<sup>8</sup>

One of the factors the Supreme Court cited in its *Quill* decision was a concern that complying with inconsistent and complicated sales tax laws would create a sizeable burden on businesses without a physical presence, which could affect interstate commerce.<sup>9</sup> Building upon efforts that began in 2000, the Streamlined Sales and Use Tax Agreement (SSUTA) was established in 2005 to “simplify and modernize sales and use tax administration in order to substantially reduce the burden of tax compliance.”<sup>10</sup> Twenty-four states, including Utah, participate in the agreement and have adopted simplification measures focused on four major goals: state-level administration of state and local taxes, a uniform tax base for all taxing jurisdictions in a state, simplified tax rates, and uniform sales origin sourcing rules.<sup>11</sup>

There are two bills currently before Congress that address collection of taxes on remote sales. The Marketplace Fairness Act of 2015, sponsored by Senator Enzi of Wyoming, would authorize SSUTA member states to require sellers with gross receipts that exceed \$1 million annually to collect and remit sales and use taxes on remote sales.<sup>12</sup> Additionally, Utah Congressman Jason Chaffetz is sponsoring the Remote Transactions Parity Act of 2015, which would authorize SSUTA member states to require all remote sellers to collect and remit sales and use taxes. The act includes a phased-in exemption scheme, exempting sellers with annual gross receipts of less than \$10 million in the first year of enactment, of less than \$5 million in the second year, and of less than \$1 million in the third year. The act authorizes non-SSUTA member states that meet certain criteria to require the tax collection for remote sales.<sup>13</sup> Utah’s legislature passed a concurrent resolution during the 2016 General Session in support of Congressman Chaffetz’s bill.<sup>14</sup>

As a member of SSUTA, Utah has adopted a number of policies that simplify its sales tax system. Additionally, Utah has enacted legislation that earmarks any future remote sales tax collections for a potential tax rate

reduction and that encourages remote sellers to collect and remit taxes voluntarily. Specifically, 2013 General Session Senate Bill 58, Amendments to Sales and Use Taxes (Harper), creates a restricted account for the deposit of revenue generated if Congress or the Supreme Court authorize Utah to require remote sellers to collect and remit sales taxes. The Legislature could then consider using this revenue to implement a tax cut. In 2013, Utah legislators also passed General Session House Bill 300, Retention of Sales and Use Tax Collections by Certain Remote Sellers, which allows remote sellers who collect sales taxes voluntarily to retain 18 percent of collections. Initial projections predicted that HB 300’s incentive would result in up to \$30 million in additional revenue collections annually but actual collections were only \$2.6 million in fiscal year 2016.<sup>15</sup>

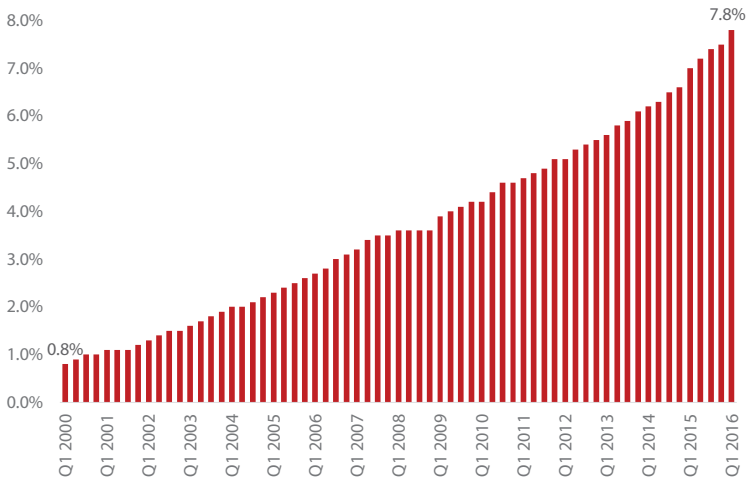
A policy that has been considered, but not passed by Utah’s legislature, is an affiliate nexus law.<sup>16</sup> Affiliates are independent companies or individuals that support the sales of another company through referrals for a commission. Affiliate nexus laws expand the definition of legal nexus to remote vendors with affiliates operating in the state, therefore requiring these vendors to collect and remit sales tax. Many online retailers operate affiliate programs; among the largest is Amazon. At least 17 states have enacted affiliate nexus, or so-called “Amazon tax,” policies.<sup>17</sup>

## Data to Consider

**The Rise of E-Commerce.** Americans are making more and more of their purchases online. E-commerce retail sales have grown 15-fold since 2000, from an estimated \$23 billion (less than one percent of all sales) to an estimated \$371 billion (almost eight percent of all sales) annually.<sup>18</sup> A recent survey by Walker Sands suggests that more Americans prefer to buy certain goods like books, electronics, and office supplies online than in person.<sup>19</sup>

**E-Retailer Nexus.** About two-thirds of the United States’ largest e-retailers have an established physical presence in Utah and therefore must collect and remit sales taxes on sales shipped into Utah.

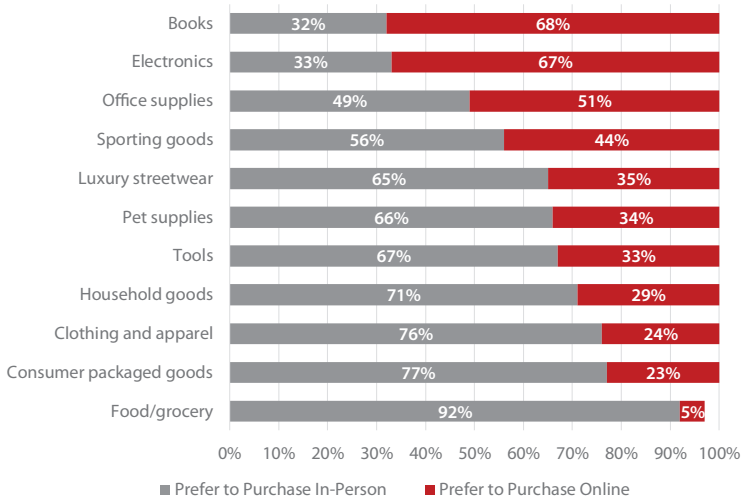
## E-Commerce Sales as a Percent of All Retail Sales in the United States



Source: US Census Bureau Retail Indicators Branch

## In-Person and Online Shopping Preferences in the United States, 2016

Percent of Shoppers Who Prefer to Purchase Goods in Person vs. Online by Commodity



Note: Values may not add up to 100 percent due to rounding.

Source: Walker Sands

**Complexity of Online Collections.** At the time of the *Quill Corp. v. North Dakota* case, there were over 6,000 sales and use tax jurisdictions (states, localities, and special districts) in the United States. One of the reasons for the physical presence standard upheld in the case was a concern that requiring sellers to track rates and collect and remit taxes for such a large number of jurisdictions would have presented a great burden on and potentially restricted interstate commerce. Today, the number of jurisdictions has grown substantially, nearing 10,000 in 2014 according to Vertex, a

## Utah Nexus for Largest United States E-Retailers

E-Retailers with at least \$2 Billion in Sales in 2015

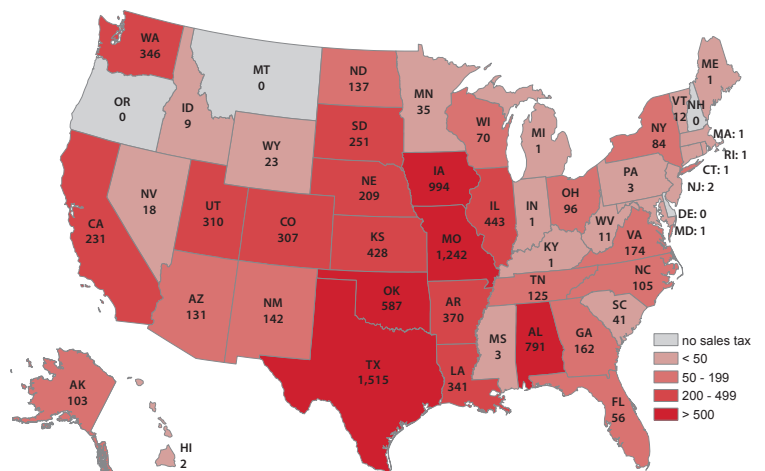
E-Retailer	2015 US Sales (\$ billions)	Utah Nexus
Amazon.com Inc.	\$92.5	No*
Apple Inc.	\$24.4	Yes
Dell Inc.	\$15.7	Yes
Walmart.com	\$13.7	Yes
Staples Inc.	\$10.7	Yes
Macy's Inc.	\$6.2	Yes
The Home Depot Inc.	\$4.7	Yes
Costco Wholesale Corp.	\$4.5	Yes
Office Depot Inc.	\$4.4	Yes
QVC Group	\$4.3	No
W.W. Grainger Inc.	\$4.1	Yes
Best Buy Co.	\$4.0	Yes
CDW Corp.	\$4.0	No
Sears Holdings Corp.	\$3.5	Yes
Google Play	\$3.5	No
Lenovo Group Ltd.	\$3.4	No
Newegg Ltd.	\$2.9	No
Nordstrom Inc.	\$2.8	Yes
Kohl's Corp	\$2.8	Yes
Gap Inc.	\$2.5	Yes
Williams-Sonoma Inc.	\$2.5	Yes
Target Corp.	\$2.5	Yes
Etsy Inc.	\$2.4	No*
Wayfair LLC	\$2.0	No

\*Affiliates with nexus in Utah must collect and remit sales tax for Utah purchases.

Source: Internet Retailer and Kem C. Gardner Policy Institute

## Sales Tax Jurisdictions, 2014

United States Total = 9,998



Source: Vertex and Tax Foundation

tax compliance software company.<sup>20</sup> However, even with growth in jurisdictions, technological advances and the wide availability of software like Vertex's and Utah-based Taxometry, have mitigated some of the complexity that the Supreme Court was concerned about.

**Fiscal Impact.** Quantifying the exact amount of state and local sales taxes that go uncollected is difficult, as comprehensive tracking does not exist. The National Conference of State Legislatures estimates that uncollected taxes on remote sales across the country totaled over \$23 billion in 2012.<sup>21</sup> Extrapolating from this estimate, the Utah Office of the Legislative Fiscal Analyst estimates uncollected state and local sales taxes in Utah in Fiscal Year 2016 totaled approximately \$230 million.<sup>22</sup>

## Policy Options to Consider

Policy makers have two major options to consider on the issue of remote sales tax collection – pass legislation that requires remote sellers to collect and remit taxes or maintain the status quo.

At the federal level, Congress can act on policies like Senator Enzi's Marketplace Fairness Act or Congressman Chaffetz's Remote Transactions Parity Act. Proponents believe that such legislation would increase equity between online retailers and "brick and mortar" stores and ease some of the growing pressures on state and local government budgets. Opponents point out that enforcing the collection of taxes on remote sales essentially increases

the tax burden on consumers, pulling funds out of household budgets and potentially creating an economic drag. The Utah Legislature and Governor Herbert have attempted to address this concern through the enactment of legislation that reserves any revenue collected as a result of congressional action on remote sales taxes for a potential tax cut.

At the state level, without further action by Congress, Utah lawmakers have limited options for additional policy changes. To encourage more voluntary collection and remittance of sales taxes, the Utah Legislature could increase incentives and/or impose reporting burdens on those remote sellers that do not voluntarily collect and remit; state lawmakers have considered these policies in the past, failing to pass them. The Legislature could also reconsider an affiliate nexus law. As with the federal policies, proponents of these state policies believe they will support increased equity and competition while opponents are concerned about increasing tax burdens, and, in the case of an affiliate nexus law, threats by remote sellers to discontinue affiliate programs in the state. At least 17 states have enacted affiliate nexus laws, and large remote sellers, like Amazon, continue to operate affiliate programs in many of these states, suggesting that policies can be tailored to mitigate impacts on Utah affiliates. To address the tax burden concern, policies that increase collection and remittance could be coupled with an offsetting tax cut.



## Endnotes

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- 1 Kem C. Gardner Policy Institute analysis of U.S. Census Bureau, Bureau of Economic Analysis, Bureau of Labor Statistics, Governor's Office of Management and Budget, and Utah State Tax Commission data. Total state sales and use tax collections include revenue earmarked for restricted expenditures.
- 2 Kem C. Gardner Policy Institute analysis of U.S. Census Bureau 2013 Annual Surveys of State and Local Government Finances.
- 3 Other factors include rate reductions on both general and food purchases, tax exemptions, and consumers shifting more and more of their spending from taxable goods to untaxed services.
- 4 Behlke, Max. *State Efforts to Collect Taxes from Remote Sellers* (NCSL Legisbrief Vol. 24, No. 13). Washington, DC: National Conference of State Legislatures, 2016.
- 5 The use tax is functionally the same as a sales tax; it just applies when a seller does not collect tax at the point of a transaction. From the Sales Tax Institute: "The sales tax is imposed on retail transactions. It applies to all retail sales of tangible personal property, and in some states services. The use tax is imposed on consumers of tangible personal property that is used, consumed, or stored in this state." *What is the Difference between Sales and Use Tax?* Accessed August 1, 2016. [http://www.salestaxinstitute.com/Sales\\_Tax\\_FAQs/the\\_difference\\_between\\_sales\\_tax\\_and\\_use\\_tax](http://www.salestaxinstitute.com/Sales_Tax_FAQs/the_difference_between_sales_tax_and_use_tax). <http://www.tax.utah.gov/forms/pubs/pub-25.pdf>.
- 6 Lunder, Erika K. and Petit, Carol A. *Amazon Laws and Taxation of Internet Sales: Constitutional Analysis* (CRS Report No. R42629). Washington, DC: Congressional Research Service, 2015.
- 7 Utah State Tax Commission: "Sales and use taxes are transaction taxes. This means the transaction is taxed, not the actual goods or services. The buyer is the actual taxpayer." "Use tax is applied to purchases of tangible personal property, products transferred electronically, and certain services when sales tax is due but not collected by the seller. A buyer without a sales tax account pays use tax to the Tax Commission on form TC-40, Individual Income Tax Return." *Sales and Use Tax General Information*. Accessed August 5, 2016. <http://www.tax.utah.gov/forms/pubs/pub-25.pdf>.
- 8 Utah State Tax Commission, e-mail message to author, August 15, 2016.
- 9 Henschman, Joseph and Borean, Richard. *State Sales Tax Jurisdictions Approach 10,000*. Washington, DC: Tax Foundation, 2016.
- 10 Streamlined Sales and Use Tax Governing Board. "About Us." Accessed August 18, 2016. <http://www.streamlinedsalestax.org/index.php?page=About-Us>
- 11 Maguire, Steven. *State Taxation of Internet Transactions* (CRS Report No. R41853). Washington, DC: Congressional Research Service, 2013.
- 12 Congressional Research Service Summary for S.698 - Marketplace Fairness Act of 2015. Accessed August 18, 2016. <https://www.congress.gov/bill/114th-congress/senate-bill/698?resultIndex=1>.
- 13 Congressional Research Service Summary for H.R.2775 - Remote Transactions Parity Act of 2015. Accessed August 18, 2016. <https://www.congress.gov/bill/114th-congress/house-bill/2775>.
- 14 2016 General Session S.C.R. 2 Concurrent Resolution in Support of Sales and Use Tax Transactional Equity.
- 15 Utah State Tax Commission, e-mail message to author, August 15, 2016.
- 16 2016 General Session HB 235, Remote Transactions Parity Act
- 17 National Conference of State Legislatures. *State Efforts to Collect Remote Sales Taxes, May 13, 2014*. Accessed August 5, 2016. <http://www.ncsl.org/ncsl-in-dc/publications-and-resources/state-efforts-to-collect-remote-sales-taxes.aspx>.
- 18 U.S. Census Bureau Retail Indicators Branch. *Estimated Quarterly U.S. Retail Sales (Adjusted): Total and E-commerce*. Last Revised May 17, 2016. <http://www.census.gov/retail/index.html#ecommerce>.
- 19 Walker Sands. Future of Retail Study 2016. Last Accessed August 7, 2016. <http://www.walkersands.com/Study-Nearly-a-Third-of-Consumers-Now-Shop-Online-At-Least-Once-Per-Week>.
- 20 Cited in Henschman, Joseph and Borean, Richard. (*Op. cit.* ix)
- 21 National Conference of State Legislatures. *Collecting E-Commerce Taxes, E-Fairness Legislation, November 14, 2014*. Accessed August 12, 2016. <http://www.ncsl.org/research/fiscal-policy/collecting-ecommerce-taxes-an-interactive-map.aspx>.
- 22 Wilko, Andrea and Young, Thomas. *October 15, 2015*. Salt Lake City, Utah: Office of the Legislative Fiscal Analyst, 2015.

### **Kem C. Gardner Policy Institute**

The Kem C. Gardner Policy Institute at the University of Utah enhances Utah's economy by placing data-driven research into the hands of decision makers. Housed in the David Eccles School of Business, its mission is to develop and share economic, demographic and public policy data and research that help community leaders make informed decisions.

### **The Hinckley Institute of Politics**

The Hinckley Institute of Politics at the University of Utah is a nonpartisan organization dedicated to engaging students and community members in governmental, civic, and political processes; promoting a better understanding and appreciation of politics; and training ethical and visionary students for careers in public service. Since its founding by Robert H. Hinckley in 1965, the Hinckley Institute has provided a wide range of impactful programs for students, public school teachers, and the general public.

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