

**Testimony Supporting  
H.B. 6624: An Act Concerning the Collection and Remittance  
of the Sales Tax by Remote Sellers  
Clay George\* and Eric Mitzenmacher\***  
Committee on Finance, Revenue and Bonding  
March 28, 2011

Senator Daily, Representative Widlitz, and distinguished Members of the Finance, Revenue and Bonding Committee,

I am testifying today on behalf of Connecticut Voices for Children, a research-based public education and advocacy organization that works statewide to promote the well-being of Connecticut's children, youth, and families. I submit this testimony because the manner in which Connecticut raises and spends its revenue is of great importance to the state's children and families.

**Connecticut Voices for Children supports H.B. 6624, An Act Concerning the Collection and Remittance of the Sales Tax by Remote Sellers because the bill:**

- **Promotes fairness** by beginning the process of closing the artificial 6% pricing disadvantage faced by in-state retailers who compete against out-of-state remote sellers, like Amazon.
- **Prepares our state for the emerging economy** in which online sales play an increasing role, in addition to sending a signal to Congress and the federal judiciary that current restrictions on taxation of remote sellers may be unsustainable and unfair in light of recent technological advances.
- **Generates up to \$10 million in sales tax revenue** that will help the state close its budget deficit.

**However, these benefits will be more effectively generated if Connecticut pairs the current proposal with mechanisms for increasing enforcement of Connecticut's current use tax or other approaches to leveling the sales tax playing field for in-state and out-of-state retailers.**

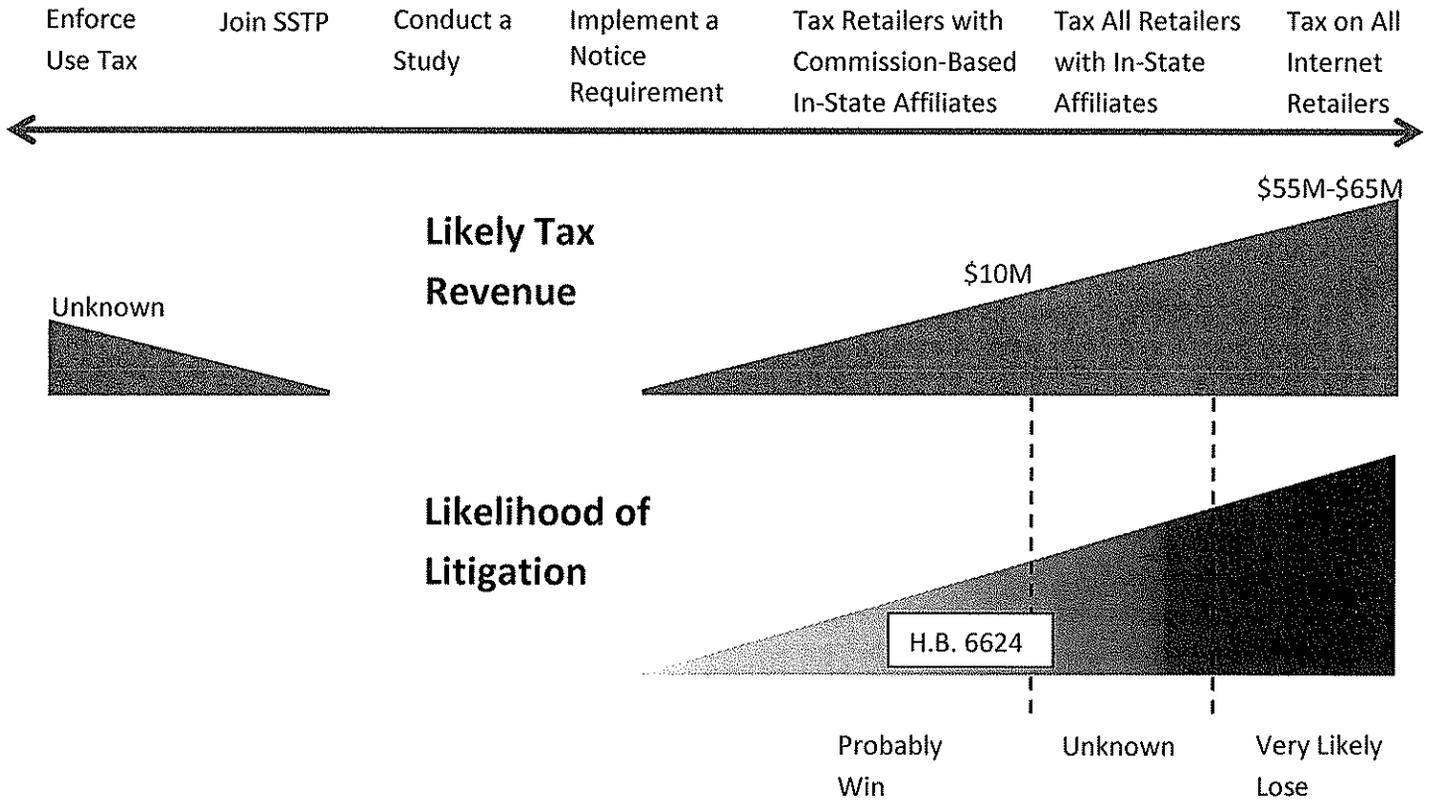
**Complementary solutions are necessary to address:**

- **Restrictive Supreme Court precedent** that, while possibly susceptible to challenge given dramatic economic and technological advances in nearly 20 years since prominent decisions were handed down, currently bars states from taxing all out-of-state sales on the basis that such taxation would subject remote retailers to the administrative burden of keeping track of over 6,000 sales tax jurisdictions.
- **Realignment of Affiliate Programs** in which remote sellers react to H.B. 6624 by exploiting the holes present in Connecticut's taxing authority and possibly reduce the bill's potential \$10 million budget impact.

---

\* Mr. George and Mr. Mitzenmacher are students at Yale Law School. This testimony was prepared through the Yale Law School Legislative Advocacy Clinic under the supervision of J.L. Pottenger, Jr., Nathan Baker Clinical Professor of Law, Shelley Geballe, Distinguished Senior Fellow at Connecticut Voices for Children and Clinical Visiting Lecturer at Yale Law School, and Jamey Bell, Executive Director at Connecticut Voices for Children.

## Online Sales Tax Portfolio of Options



Option	Description	Pros	Cons
Do Nothing	Do not address the issue this year	<ul style="list-style-type: none"> <li>- No negative reaction from online retailers</li> <li>- Might be able to piggyback on other states' efforts to change federal law</li> </ul>	<ul style="list-style-type: none"> <li>- Does nothing to prepare Connecticut for an evolving economy</li> <li>- No revenue</li> <li>- Local retailers will remain at a price disadvantage</li> </ul>
Conduct a Study	Commission the Department of Revenue Services to develop a plan for future taxation	<ul style="list-style-type: none"> <li>- Signals to citizens, retailers and other governmental bodies that this is a serious issue</li> <li>- No negative reaction from online retailers</li> </ul>	<ul style="list-style-type: none"> <li>- No revenue</li> <li>- Local retailers are still at a price disadvantage</li> </ul>
Join Streamlined Sales Tax Project (SSTP)	Modify current sales tax laws to comply with the Streamlined Sales Tax Project	<ul style="list-style-type: none"> <li>- Presents an opportunity to participate in action that could challenge the factual predicates of <i>Quill</i> and allow the Supreme Court to overturn it without any change to the underlying rule of law</li> </ul>	<ul style="list-style-type: none"> <li>- No revenue</li> <li>- Requires modification of some aspects of CT's sales tax law</li> <li>- "Simplifications" will be substantive, not merely minor changes in procedure</li> <li>- Potentially few short term benefits until more states join</li> </ul>
Enforce Use Tax	Increase awareness and enforcement of Connecticut's current use tax laws	<ul style="list-style-type: none"> <li>- Already law</li> <li>- No negative reaction from online retailers</li> </ul>	<ul style="list-style-type: none"> <li>- Unlikely to garner much revenue</li> <li>- May be perceived as a tax increase or new tax, since many believe online sales simply are not taxed currently</li> </ul>

Implement a Notice Requirement	Force online retailers to include a notice on the customer's receipt that the customer may owe CT use tax on the purchase	<ul style="list-style-type: none"> <li>- May encourage people to pay the use tax</li> </ul>	<ul style="list-style-type: none"> <li>- Unlikely to generate much revenue</li> <li>- Small possibility of litigation</li> <li>- Possible negative reaction from some online retailers</li> </ul>
Tax Retailers with Commission-Based In-State Affiliates	Collect sales tax directly from any online retailers utilizing in-state affiliates that are paid on a commission basis	<ul style="list-style-type: none"> <li>- Estimated to generate \$9M in additional tax revenue</li> <li>- Best matches <i>Tyler Pipe's</i> "sales force" interpretation for meeting <i>Quill's</i> requirements</li> <li>- Begins to level the playing field for local retailers</li> </ul>	<ul style="list-style-type: none"> <li>- Likely to generate a negative reaction from some online retailers</li> <li>- Could lead to a termination or modification of the affiliate programs</li> </ul>
Tax All Retailers with In-State Affiliates	Collect sales tax directly from any online retailers utilizing in-state affiliates, regardless of the affiliates' form of compensation	<ul style="list-style-type: none"> <li>- Would generate somewhat more revenue than the above option</li> <li>- Not as susceptible to avoidance through minor contract modifications with affiliates</li> </ul>	<ul style="list-style-type: none"> <li>- Less directly matches that facts of Supreme Court precedent on allowable taxation</li> <li>- Would likely generate an even more negative reaction from some online retailers</li> </ul>
Tax on All Internet Retailers	Implement a sales tax on all online sales	<ul style="list-style-type: none"> <li>- Could capture around \$55M to \$65M in lost revenue</li> <li>- Would fully level the playing field for local retailers</li> </ul>	<ul style="list-style-type: none"> <li>- Would almost certainly lose in court unless <i>Quill</i> can be overruled or narrowed in a direct challenge</li> <li>- Would generate a very strong negative reaction from online retailers</li> </ul>

## PROMOTES FAIRNESS

### Why is an online sales tax important?

Collecting tax on online sales transactions, either directly from retailers or through stepped-up enforcement of the current use tax, addresses two significant problems— tax revenue leakage and inequitable tax treatment across businesses.

The current structure of sales taxation unfairly disfavors in-state retailers and, in particular, traditionally smaller, brick-and-mortar businesses. Because relatively few consumers actually pay the use tax they owe, either intentionally (because they know that enforcement is minimal) or inadvertently (because they do not know the tax exists), out-of-state online retailers enjoy a 6% pricing advantage. Moreover, even if the use tax is enforced, online retailers may still enjoy a perceived price advantage since there is a great deal of time between the online purchase and payment of the use tax. In the retail industry, where profit margins tend to be small, a 6% price change can mean the difference between profitability and failure. Many local retailers therefore cannot afford to match remote sellers' prices on a post-tax basis. Given this situation, and the convenience of online shopping, there should be no surprise that, increasingly, Connecticut residents are purchasing goods online, rather than in Connecticut's local stores. Indeed, leading e-commerce vendors openly admit that their exemption from collecting sales taxes is an important component of their profitability.<sup>1</sup>

While this legislation and other possible options help to increase the equity of the tax system between in-state and out-of-state retailers, they represent partial solutions. But these efforts at the state-level can

serve as a signal to the judicial system and the federal government that updating the law in this area is a pressing need. In addition to Connecticut's efforts, California, Illinois, Hawaii, New Mexico, Minnesota, and Vermont have also introduced legislation this year exploring a range of policy alternatives to collect at least *some* of this lost revenue.<sup>ii</sup>

## PREPARES OUR STATE FOR A MODERNIZING ECONOMY

Electronic sales represent a significant and expanding fraction of total retail sales.<sup>iii</sup> According to the U.S. Census Bureau, \$127 billion in business-to-consumer sales occurred online in 2007, equal to 3.2% of retail sales.<sup>iv</sup> Moreover, respected forecaster Forrester Research projected that online retail sales would top \$172 billion in 2010 and grow 10% per year until 2015.<sup>v</sup> Accordingly, Connecticut is already losing meaningful tax revenue and the leakage will continue to increase over time.

## GENERATES REVENUE

**How much tax revenue is expected from extending the sales tax?**

Economists from the University of Tennessee have estimated that the exemption of online retailers prevented Connecticut from collecting \$48.3 million in sales tax revenue in 2010, a number that would grow to \$63.8 million by 2012.<sup>vi</sup> This estimate accounts for the fact that retailers with both an online *and* a physical presence in Connecticut already are required to collect sales tax on electronic purchases.

The proposed legislation would tax only those entities— like Amazon.com— that have no physical presence in Connecticut but have in-state affiliates, with a revenue gain estimated by the Office of Fiscal Analysis of \$9.3M (in 2010).<sup>vii</sup>

## RESTRICTIVE LEGAL PRECEDENT

**What prevents Connecticut from taxing all online sales?**

Benjamin Barnes, Secretary of the Office of Policy and Management, has stated, “We don’t even have the legal ability to tax internet sales right now.”<sup>viii</sup> States are precluded from taxing the entire range of out-of-state online sales because the Supreme Court has found that some of these retailers do not have enough of a connection with the state to impose such an administrative burden on them.

States’ authority to tax the sales of out-of-state companies exists in tension with delegation to the federal government of the power to regulate interstate commerce. The United States Supreme Court has resolved this tension, generally, by requiring that a company have “nexus” with a jurisdiction before it may be compelled to remit any tax. For sales tax purposes, the seminal case on the “nexus” issue is the Supreme Court’s 1992 decision in *Quill v. North Dakota*, which invalidated a collection requirement for a mail-order vendor that did not maintain a “physical presence” in North Dakota.<sup>ix</sup> Therefore, Secretary Barnes is nearly certainly correct that current Supreme Court precedent prevents taxing *all* Internet sales.

The nexus requirement of the Commerce Clause exists to “limit the reach of state taxing authority so as to ensure that state taxation does not unduly burden interstate commerce.”<sup>x</sup> At the time *Quill* was

decided, the Supreme Court felt that “the Nation’s 6,000-plus taxing jurisdictions... [with] many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle [a mail-order house] in a virtual welter of complicated obligations.”<sup>xi</sup> However, with today’s information technology resources, online retailers like Barnes & Noble collect and remit sales taxes in all states, regardless of whether a purchase is made in-store or on the company’s website,<sup>xii</sup> and, ironically, even Amazon calculates, collects and remits sales tax on purchases made through its own website on behalf of businesses with nexus to the customer’s state (such as Target), undermining the argument that it would be too burdensome to do the same on purchases directly from Amazon itself.

## POSSIBLE NEGATIVE REACTIONS

### How are retailers likely to react to an extended online sales tax?

Amazon and some other online retailers have loudly protested any attempts at taxation. Even in Texas, where Amazon arguably has a physical presence, the corporation has refused to pay \$269 million in sales taxes and has planned to close its distribution center. This action would cost the state 119 jobs and the threat has created tension between the governor and the state comptroller.<sup>xiii</sup> Similar public quarrels between legislators and online retailers have occurred in Rhode Island, New York, North Carolina and Colorado.<sup>xiv</sup>

In other states, Amazon’s first move has been to threaten cancellation of its affiliate agreements. The company has actually carried out this threat in Colorado, North Carolina and Rhode Island, but has retained affiliates in New York, possibly to ensure continued standing in its current lawsuit. Yet, threatened affiliate program cancellations may not be as dire as they seem. In fact, Barnes & Noble has issued an open letter to all Amazon affiliates inviting them to join B&N and have B&N take care of remitting the sales taxes for them.<sup>xv</sup> Moreover, other retailers, such as Wal-Mart and Sears, have made similar overtures.<sup>xvi</sup> This type of market response could reduce the impact of implementing an expanded sales tax on the local Connecticut businesses that have affiliated themselves with remote sellers.

### Could H.B. 6624 be successfully challenged in court?

Under our analysis, H.B. 6624 would probably survive legal challenge, though the precedent becomes less clear for those in-state affiliates that work on a non-commission basis. H.B. 6624 is similar to the recently-enacted legislation in New York that has come to be known as the “Amazon Tax.” So far, the New York court system has upheld the Amazon Tax despite the fact that it encompasses click-through affiliates.<sup>xvii</sup> However, several legal commentators have noted that such traditional advertisements and click-through arrangements are difficult to characterize as sales agent relationships.<sup>xviii</sup>

Both H.B. 6624 and New York’s Amazon Law seek to stay within the boundaries delineated by Supreme Court precedent. They find their greatest support in *Tyler Pipe Indus., Inc. v. Wash. State Dept of Revenue* (1987). While *Quill* is the most recent Supreme Court case directly on point, the Court’s other multi-state taxation precedent provides more detail on what is allowable. *Quill*’s legal reasoning is grounded in cases that describe more fully what commercial activity could constitute a “physical presence” that would result in “nexus.” In particular, in *Tyler Pipe*, the Court held that the presence of a sales force within a state is sufficient to establish “physical presence” if the sales force plays a substantial role in maintaining a vendor’s market in the state, regardless of whether the salespeople are

employees of a company or mere independent contractors. One common reading of *Tyler Pipe* is that a retailer has a “physical presence in a state if it uses in-state third parties to help ‘establish and maintain a market’ for its goods within the state.”<sup>xix</sup> Thus this precedent would seem to allow states to tax companies who contract with in-state affiliates on a commission basis, and possibly for other types of consideration, though that is dealt with less explicitly.

## COMPLEMENTARY SOLUTIONS

**What other solutions are states pursuing to gain sales tax authority?**

### *Use Tax:*

The primary complement to the proposed legislation is to enhance collection of the use tax. While H.B. 6624 applies to a restricted number of online sales (though with a presumably high compliance rate), the use tax applies to all otherwise untaxed online sales as well as catalog sales and all out of state purchases for which no sales tax was paid. The use tax, however, has a historically low compliance rate, either because of a lack of knowledge of the tax, a belief that it is laxly enforced, or the burdensomeness of collecting the relevant information.

The deficiency of taxpayer knowledge regarding the use tax could be rectified by highlighting and better explaining the relevant section on the income tax form, by requiring online retailers to include a conspicuous use tax notice on their receipts (for example, advising purchasers that while no sales tax was levied on the purchase, the purchaser may still be liable for use tax on it), or even by requiring internet providers to include an informative notice on people’s monthly internet bills. These latter two options are untested uses of state power under *Quill* and related cases, but they would impose less of an administrative burden than requiring a company to calculate and/or remit a tax.

The taxpayer’s burden of collecting the relevant information required to calculate the use tax they owe could be addressed by offering a choice between the current requirement of itemizing all internet purchases over \$20, or selecting a standard tax based on the taxpayer’s adjusted gross income. Another possibility would be to incentivize third parties like internet providers, banks or TurboTax to create web tools that would allow people to easily record their purchases as they made them and pay the bills on a monthly, automated basis. This system could offer a lower tax rate to the taxpayer as an incentive and the third party could be motivated by allowing them to keep the interest generated between when people make the monthly payments and when the taxes must be remitted to the state.

### *Streamlined Sales Tax Project:*

Another alternative would be to address *Quill*’s concerns directly by simplifying the multitude of diverse sales tax jurisdictions. Connecticut cannot singlehandedly solve this problem, but it could join the Streamlined Sales Tax Project (SSTP), a coalition movement currently comprising 20 states that seeks to adopt common sales tax rules in an effort to assault the ground on which *Quill* rests. Connecticut considered joining the SSTP in 2008, but identified several attributes of the Connecticut sales tax law that would need to be revised before joining. These include: (1) conforming to a prohibition on multiple sales tax rates (e.g. the 12% room occupancy tax), (2) conforming to a prohibition of exemptions based on the value of an item (e.g. Connecticut’s current sales tax exemption for clothing under \$50), and (3) possibly reforming the Connecticut tax treatment of services.<sup>xx</sup> This alternative also has the downside of investing Connecticut funds in the SSTP with no absolute guarantee that it will

result in increased tax revenue generation, though commissioning a detailed study by the Department of Revenue Services might provide a useful cost-benefit analysis.

Thank you for the opportunity to submit this testimony.

- <sup>i</sup> For example, Amazon's 2008 10-K report states that "A successful assertion by one or more states...that we should collect sales or other taxes on the sale of merchandise or services could...decrease our ability to compete with traditional retailers and otherwise harm our business." Amazon.com, Inc., 2008 Form 10-K, at 14. See generally Michael Mazerov, Ctr. On Budget & Pol'y Priorities, *Amazon's Arguments Against Collecting Sales Tax Do Not Withstand Scrutiny* (2009), <http://www.cbpp.org/files/11-16-09sfp.pdf>
- <sup>ii</sup> Verne Kopytoff, *Amazon Pressured on Sales Tax*, The New York Times, <http://www.nytimes.com/2011/03/14/technology/14amazon.html?pagewanted=1&r=3&ref=business>, March 13, 2011.
- <sup>iii</sup> Estimated by backing out sector growth from sales tax revenue figures, Connecticut's e-commerce activity is projected to have increased at an annualized rate of 9.5% between 2007 and 2012. See Donald Bruce, William F. Fox, and LeAnn Luna, *State and Local Government Sales Tax Revenue Losses from Electronic Commerce*, The University of Tennessee, Apr. 13, 2009, tbl. 3.
- <sup>iv</sup> U.S. Census Bureau, E-Stats, May 28, 2009, <http://www.census.gov/econ/estats/2007/2007reportfinal.pdf>
- <sup>v</sup> *E-Retail Will Influence 53% of Purchases by 2014*, Forrester Says, Internet Retailer, Mar. 8, 2010, <http://www.internetretailer.com/dailyNews.asp?id=33828>.
- <sup>vi</sup> See Bruce, *supra* note i, tbl. 5.
- <sup>vii</sup> Lockhart, Brian, Lawmakers eye 'Amazon tax' on Internet purchases to close budget gap, <http://www.newstimes.com/local/article/Lawmakers-eye-Amazon-tax-on-Internet-purchases-1044002.php>, March 5, 2011.
- <sup>viii</sup> Ed Jacovino, Governor not pushing to tax Amazon, Internet sales, The Hour, <http://www.thehour.com/story/499803>, Feb. 21, 2011.
- <sup>ix</sup> See *Quill v. North Dakota*, 504 U.S. 298, 317 (1992).
- <sup>x</sup> See *Quill v. North Dakota*, 504 U.S. 298, 317 (1992).
- <sup>xi</sup> See *Quill v. North Dakota*, 504 U.S. 298, 317 (1992).
- <sup>xii</sup> Barnes & Noble, General Tax Information – Barnes & Noble, <http://www.barnesandnoble.com/help/cds2.adp?PID=8115> (last visited Mar. 14, 2010).
- <sup>xiii</sup> Ana Campoy, *Amazon's Exit Spurs Tax Fight in Texas*, The Wall Street Journal, <http://online.wsj.com/article/SB10001424052748703961104576148634038574352.html>, Feb., 17, 2011.
- <sup>xiv</sup> Jeff Jacobson, *Internet Sales Tax Impacts Amazon's Affiliates*, Practical Ecommerce, <http://www.practicalecommerce.com/articles/2597-Internet-Sales-Tax-Impacts-Amazon-s-Affiliates>, Feb. 18, 2011 and Amy Martinez, *ACLU, Amazon end fight with N. Carolina over privacy*, The Seattle Times, [http://seattletimes.nwsourc.com/html/business/technology/2014178437\\_amazontax10.html](http://seattletimes.nwsourc.com/html/business/technology/2014178437_amazontax10.html), Feb. 9, 2011.
- <sup>xv</sup> John Foley, President of BN.com, Barnes & Noble Open Letter to Amazon Affiliates, [http://www.barnesandnobleinc.com/press\\_releases/2011\\_feb\\_14\\_amazon\\_affiliates.html](http://www.barnesandnobleinc.com/press_releases/2011_feb_14_amazon_affiliates.html), Feb. 14, 2011.
- <sup>xvi</sup> Miguel Bustillo & Stu Woo. *Retailers Push Amazon on Taxes*. Wall St. J., Mar. 17, 2011, at B1.
- <sup>xvii</sup> See *Amazon.com, LLC v N.Y. State Dep't of Tax'n & Fin.*, 877 N.Y.S.2d 842, 847-48 (N.Y. Sup. Ct. 2009).
- <sup>xviii</sup> Daniel Tyler Cowan, *New York's Unconstitutional Tax On The Internet: Amazon.Com v. New York State Department Of Taxation & Finance And The Dormant Commerce Clause*, 88 NCLR 1423, May 2010; Zelda Ferguson, *Is The Tax Holiday Over For Online Sales?*, 63 Taxl 1279, Summer 2010; and Sam Zaprzalka, *New York's Amazon Tax Not Out Of The Forest Yet: The Battle Over Affiliate Nexus*, 33 SEALR 527, Winter 2010.
- <sup>xix</sup> Michael Mazerov, Ctr. On Budget & Pol'y Priorities, *Amazon's Arguments Against Collecting Sales Tax Do Not Withstand Scrutiny* (2009), <http://www.cbpp.org/files/11-16-09sfp.pdf>
- <sup>xx</sup> Connecticut Streamlined Sales Tax Commission, *Streamlined Sales Tax Commission Report* (January 2008), <http://www.ct.gov/drs/lib/drs/research/streamlinedsaletaxreport/streamlinedsaletaxreportjan08.pdf>, January 2008. With respect to the tax treatment of services the Streamlined Sales Tax Commission Report says that "Connecticut, unlike many other states, taxes a broad array of enumerated services under the sales and use tax. The SSUTA requires that a state must use destination sourcing for taxing services. Under the agreement, general sourcing definitions for receipt of services is where the services are first used. However, the Governing Board has not fully clarified what destination means for services, which could pose a problem for Connecticut."