

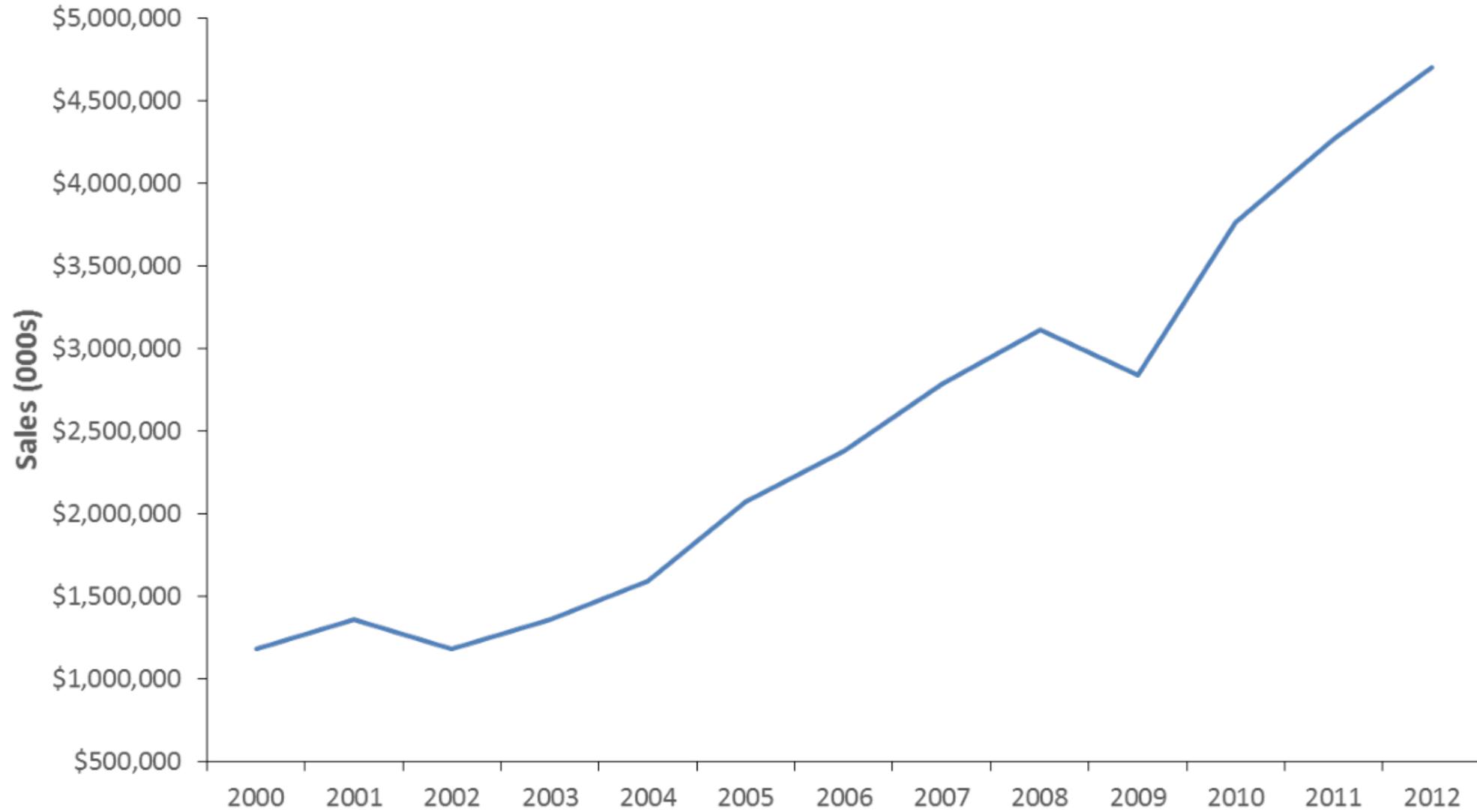
Sales Taxes in an e-Commerce Generation

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Introduction

- Issues of cross-border shopping and mail order catalogs have long challenged the administration of indirect taxes based on the destination principle.
- Online transactions and the recent expansion of digital products (such as mp3s) place new pressures on these taxes both under retail sales and value added tax systems.
- What are the policy options available if we desire to have a destination based tax systems and how do we evaluate each of these reforms?

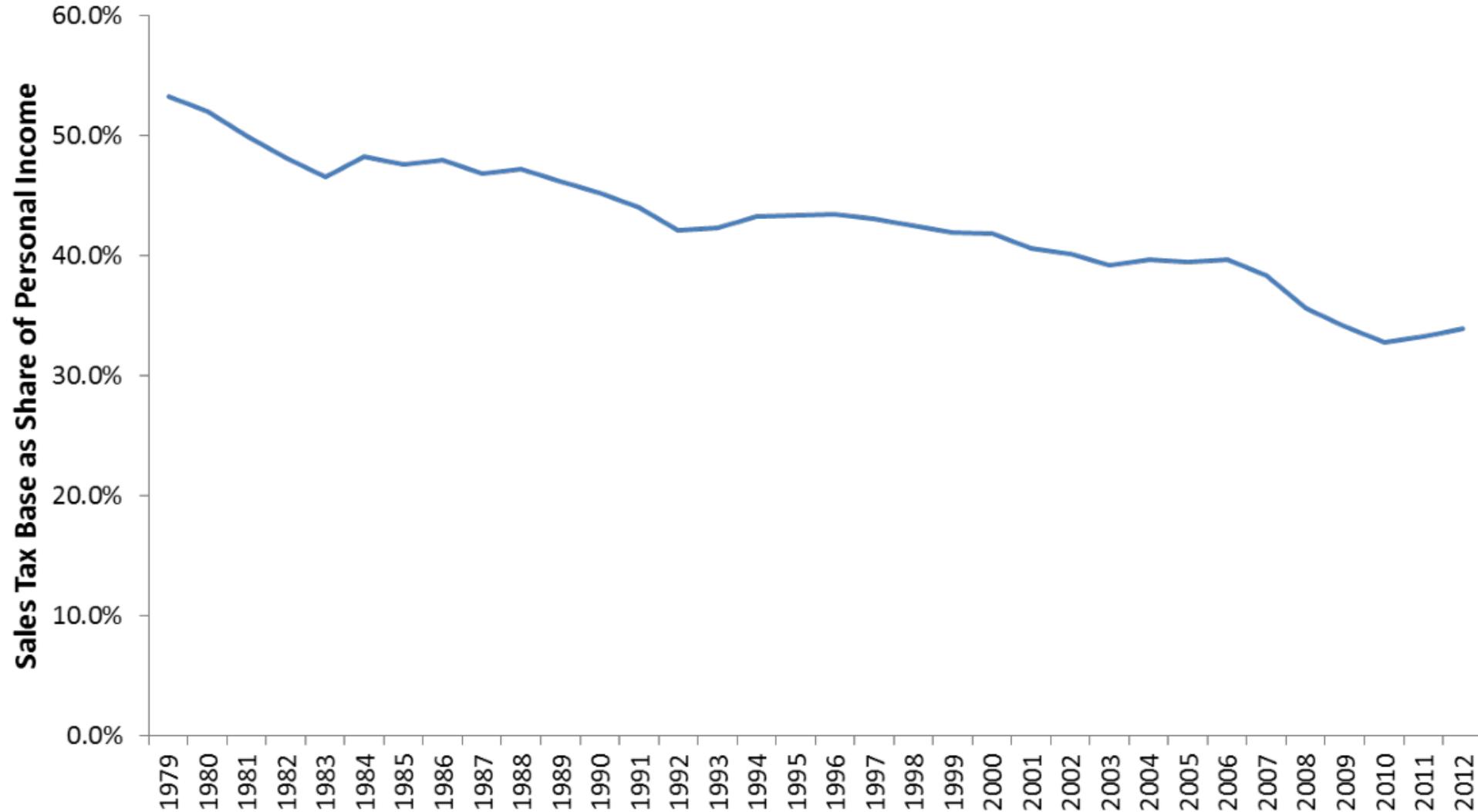
E-Commerce Sales



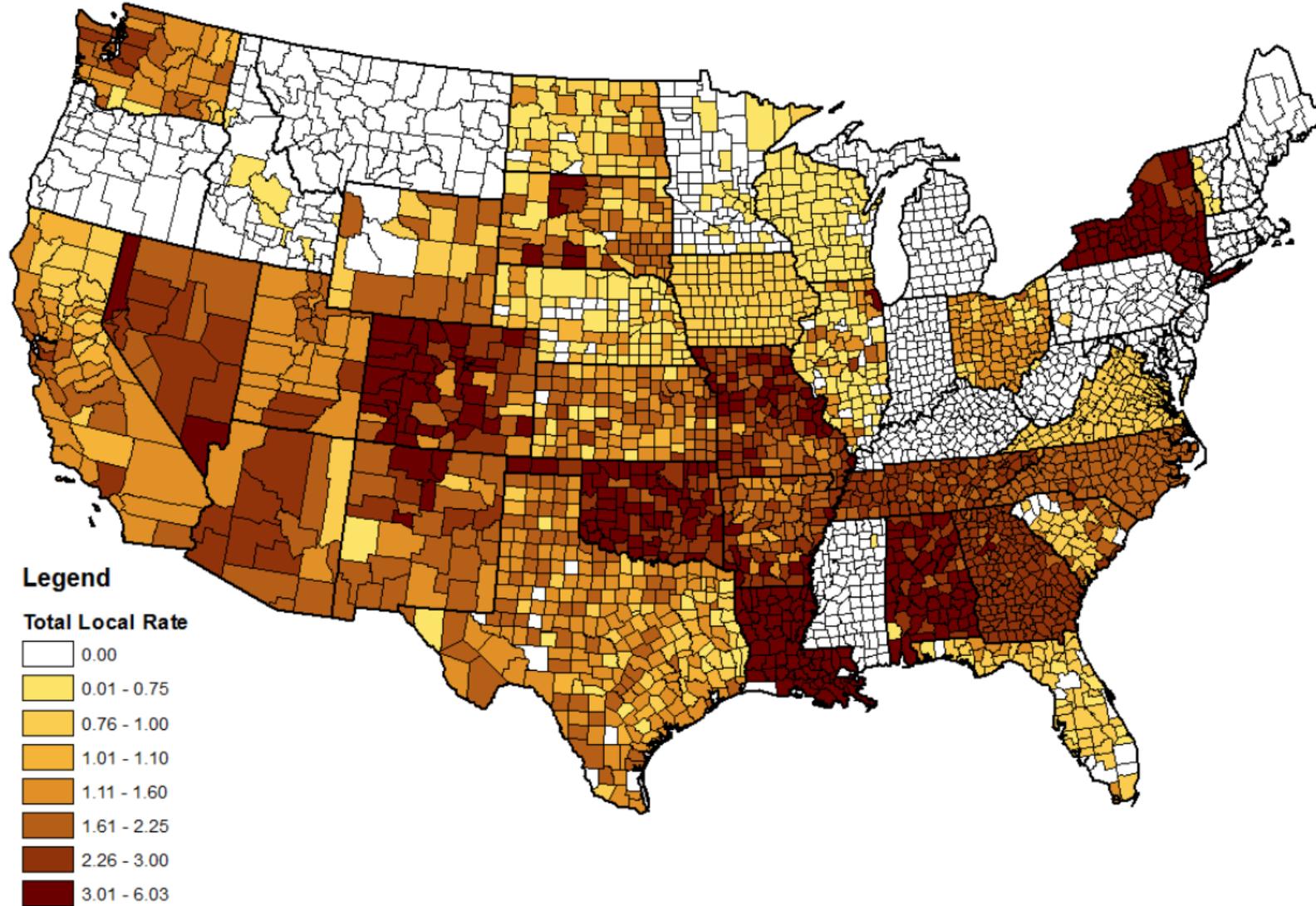
Basic Facts Regarding e-Commerce

- Remote retail sales are dominated by e-commerce.
 - 66.9% are e-commerce and mail order are only 33.1%.
- Estimates indicate that 11% of business to consumer transactions occurred on eBay while approximately 13 to 19 percent occurred on Amazon.com.
- Although many transactions are from distant sellers, a disproportionately high fraction of transactions occur between same-state buyers and sellers.

Tax Base as a Percentage of Personal Income



A Highly Decentralized Tax



Destination Structure

- Vendors with a physical presence generally remit sales taxes.
- Use taxes shift burden of tax remittance to the buyer when the tax was not assessed by the seller.
 - Out-of-state purchases are taxable in destination state.
 - Use or storage occurs in the destination state.
 - Sales tax was not paid or paid at a lower rate.
- Taxes on e-commerce are use taxes (remitted by buyer or seller depending on nexus).
- Use taxes within a state vary based on state statutes.

Nexus Rules: *Quill Corp. v. North Dakota*

- Physical presence from which a company profits is a necessary component to establish nexus.
 - Firms with nexus remit taxes to the state.
 - When the firm does not have nexus, the obligation shifts to the buyer and use tax evasion becomes more common.
 - The definition of what establishes physical presence is left up to the states with possible court tests arising.

Use Tax Compliance

- Low when consumer is required to remit.
 - Zero to 10 percent of people file a non-zero use tax return.
 - High compliance on large products like cars where the tax is often assessed at a DMV office.
- Noncompliance also arises when the consumer is a business although not as much as for individuals.
- Mechanisms to collect the tax vary by state.

Preferential Tax Rates for Online Transactions

- In a Ramsey framework: elasticity of online products vs. elasticity of brick-and-mortar products.
 - Einav et al (2014) estimate elasticity of online goods that is generally greater than 1.5.
 - Compare to cross-border elasticities (approximately 1).
 - But likely misleading because online elasticities likely capture online platform substitution.
- Zodrow (2006) shows preferential rates for e-commerce requires the taxation of e-commerce yield a net increase in the supply of labor.
 - Harder to justify with equity concerns in the model.

Compliance Costs

- Most firms are compliant in at least one state, so added compliance costs would come from remitting in more states and not from a first time collection.
- Compliance costs likely to differ based on firm size.
 - Most online firms are small but firms with over one million dollars of sales account for about 57 percent of B2C e-commerce.
- Gamage and Heckman (2012): “a state desiring to subject remote vendors to its use tax should only need to adequately compensate the remote vendors for the compliance and reporting costs thereby imposed.”

Efforts to Enforce Destination Taxation

1. Do nothing or encourage firms to locate in a state.
2. Change nexus rules.
3. Require information reporting.
4. Income tax filing or improve ease of use tax filing.
5. Marketplace Fairness Act.
6. Attempt to re-litigate Quill.
7. Policy reforms abroad that might shed light on RST.

Do Nothing / Incentives for Firms

- If states do nothing, the number of firms with nexus may increase over time simply because firms like Amazon have begun to enter more and more markets.
 - However, this strategy is likely only profitable for large firms.
 - States without transportation hubs may be disadvantaged.
 - If large firms do establish over time, do another set of smaller firms try to fill the “zero tax” option void?
- Alternatively, we may see states engage competitively for firms.
 - Fiscal competition / bidding for firms in an effort to encourage nexus.

Nexus Rules

- Attributional nexus: arises when states assert nexus over a firm because it has a relationship with another firm that has a physical presence.
- Click-through-nexus: enacted in about 20 states.
- Expansive definitions of nexus potentially test the boundaries and may be subject to potential reviews by courts.
- Economic evidence provides a cautionary argument:
 - Targeted changes to nexus (Amazon laws) reduce spending on Amazon by 9.5% but increase spending 19.8% on competing retailer websites.

Information Reporting

- States could require vendors without nexus to provide information on sales by customers without remitting the tax.
 - Possible to send this information to the purchaser or the tax authority.
- Example: Amazon agreed to send information on all purchases to the buyer and no note they may be subject to the use tax.
- Example: Colorado law requires firms without nexus to send the dollar value of purchases to the tax authority.
- This “information reporting” contrasts to possible “nudges” by the state government (Anderson 2014).
 - Think of it in similar context to individual income tax reporting.

Use Tax Filing

- Increase compliance by lowering the compliance costs to individuals.
 - Individual income tax filing.
 - Provide information in the income tax return.
 - Require tax payers to declare “0” use tax liability.
- Manzi (2012) notes differences arise depending on the mechanism, but compliance gains are modest.

Marketplace Fairness Act

- Congress has the authority to legislate and require remote firms to remit taxes regardless of nexus status.
- The Act requires states to simplify the tax system in an effort to lower compliance costs in order to require firms to collect the tax.
- Usually exempts small firms (under 1 million in sales)
 - Creates a notch, but not likely to result in bunching because fewer than 2000 firms above the notch.
 - Only problematic if firms divide themselves informally.
- Behavioral response could result in consumers shifting to small firms.
- How to balance compliance costs with complete coverage...

Attempt to re-litigate *Quill*

- Supreme Court Justice Kennedy recently argued that the decision should be reconsidered (*Direct Marketing Association v. Brohl*).
- States may pass a law with the idea that it will be challenged in the courts.
 - Economic nexus: “out-of-state sellers who lack an Alabama physical presence but who are making retail sales of tangible personal property into the state have a substantial economic presence in Alabama for sales and use tax purposes and are required to register for a license with the Department and to collect and remit tax” if certain conditions are met (greater than \$250,000 sales in state).
- If re-litigated, then the Court will likely set the rules rather than Congress.
- May provoke faster action by Congress, but likely to lose in lower courts.

Policy Reforms Abroad

- Recently, the EU required that the taxes on *digital* products be assessed on the basis of the destination principle for transactions within the EU.
- One source of opposition was Luxembourg, which had a preferential tax rate for digital products.
 - Country was compensated with revenue grants in the short run.
- Another worry was added complexity for firms.
 - Mini one-stop shop: firms file a single quarterly return in the country where they are located and this country then distributes revenue to other member states in accordance with the return.

Conclusion

- Digital economy is raising new and important policy questions for the design of indirect tax systems especially in decentralized federations.
- We conclude the strongest case is for similar taxes on e-commerce as brick-and-mortar transactions along with broad efforts to enforce destination taxation.
- Considerable empirical research continues to be needed in this area.