An Uncertain Future for Online Sales Tax
By Kenneth Kron, CPA, Tax Partner

Cyber Monday 2013 was the biggest online shopping day in U.S. history. It was also the day the U.S. Supreme Court refused to hear a constitutional challenge by Amazon and Overstock to a 2008 New York law that requires out-of-state online retailers to collect sales tax if they use in-state affiliates to direct traffic to their websites.

New York, Illinois, Texas and California have enacted these so-called "Amazon Laws," prompting a debate on whether it's fair to require out-of-state online retailers to collect sales tax.

Significant tax revenues are at stake in the online sales tax debate. For example, online sales are expected to grow 15 percent to $78.7 billion in November and December 2013, according to Forrester Research. Using an average state sales tax rate of about 5.6 percent, $4.4 billion could be on the table this holiday season alone. Many online retailers are not currently collecting sales tax.

Sales Tax History Lesson
If you operate a brick-and-mortar store, you typically charge customers sales tax based on applicable state and local rates where your business is located.

Sales tax laws vary from location to location. Some states charge different sales tax rates for different items. For example, cigarettes and alcohol can have a higher sales tax rates than food. (In many states, food purchased for home consumption is exempt from sales tax.) Cities and counties may levy additional taxes, as in New York.

A landmark 1992 Supreme Court case – Quill Corp. v. North Dakota – determined that mail order retailers must have a substantial physical presence (or nexus) in the state in order to be required to collect sales tax from customers. In addition to a storefront, nexus also might include a

Sales Tax Now – or in Some Cases, Use Tax Later

Online shopping may allow you to avoid crowds at the mall this holiday season. But it generally doesn't allow you to avoid paying sales tax. Paying taxes on online purchases is the law in most jurisdictions -- whether it's collected at the time of purchase or later.

It's true that five states (Alaska, Delaware, Montana, New Hampshire and Oregon) don't charge sales or use taxes. This tax-free status applies to in-store and online purchase.

Purchases in the remaining 45 states and the District of Columbia incur combined state and local sales tax rates that generally range from 6 to 10 percent. If you don't pay sales tax at the time of purchase, you're supposed to track your sales-tax-free purchases and pay use tax on those purchases along with your state income tax return.

Use tax applies to businesses and individuals, but many buyers are unaware of (or ignore) it. Some states are reinforcing their collection efforts, however. If you make large, tax-free purchases online, it's increasingly possible that state taxing authorities could find out, audit you and impose back taxes and penalties.
warehouse, factory, office or employees in a given state. The rationale behind the Quill decision was that requiring out-of-state retailers to collect varying levels of state and local sales taxes is burdensome, especially for small businesses.

**Amazon Laws**

Today, the "physical presence" requirement set forth in Quill has been extended to online retailers. But some states have decided that physical presence is an outdated concept in a digital world. They argue that current technology simplifies the process of collecting sales tax for products sold across state lines, thereby eliminating the rationale underlying Quill.

States that seek additional tax revenues have enacted "Amazon Laws," which extend the concept of nexus to include the use of in-state affiliates to direct business to retail sites operated across state lines. For example, if a museum located in New York directs traffic to an out-of-state Internet business, the site must collect sales tax from New York residents, even if it has no other physical presence in New York. Amazon Laws essentially treat affiliates similar to operating a sales force within state lines.

Amazon Laws have received mixed responses from the courts. The Illinois Supreme Court sided with Amazon and overturned that state's online sales tax collection requirement in 2013. But the New York Supreme Court upheld its Amazon Law – although the U.S. Supreme Court refused to hear an appeal of this case in early December.

The Court's refusal doesn't set a legal precedent, but it paves the way for more states to enact Amazon Laws. The refusal might pressure Congress to standardize the rules governing online sales tax collection.

**Proposed Marketplace Fairness Act**

Last May, the Senate passed the Marketplace Fairness Act, which aims to simplify the sales tax collection process for online retailers. But the bill stalled in the House. In a nutshell, the proposed legislation would require Internet companies with more than $1 million in annual sales to collect sales tax on purchases made by consumers and businesses in states that meet certain requirements. Online retailers with $1 million or less in annual sales (and without nexus in the state) would continue to be exempt from collecting sales tax.

In exchange for the right to collect online sales tax, a state would be required to provide retailers with free calculation software and a rate database for goods or property sold in their jurisdiction. Many online and big box retailers – including Walmart, Target, and Amazon – currently support the Marketplace Fairness Act.

**An Ongoing Debate**

The future of online sales tax legislation remains uncertain. But proactive retailers can take steps to address the sales tax issue today. For example, some retailers voluntarily collect sales tax on all online purchases without waiting for states to require it.

At a minimum, anyone who sells goods or property online needs to stay on top of emerging state and federal sales tax collection laws. Consult with your tax adviser to decide on the most prudent courses of action in the states where you do business.

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