Remote seller state sales and use tax collection and compliance is a significant and increasing economic issue for state and local jurisdictions, especially given the impact on interstate commerce and Congress’ Commerce Clause authority to regulate in that area. In this article, author Thomas J. Godfrey explains why there is compelling need for Congress to act quickly and move a legislative solution forward for enactment.

Remote Seller Sales & Use Tax Collection: Online Sales; Marketplace Fairness; Act Now

BY THOMAS J. GODFREY

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Executive Summary

In 2013, the National Governor’s Association estimated that “states lose as much as $23 billion a year” in sales and use taxes that should be collected, but aren’t, when a taxable retail transaction or use occurs in a particular state and the out-of-state (remote) seller does not have a physical presence in that state. Thus, in contrast to a retail seller who does have a physical presence in that state, the remote seller cannot be required to pay the relevant sales and use tax to the

appropriate state or local tax authority based on current federal law. The fact that the sales and use tax cannot be collected from the remote seller does not diminish the corollary use tax obligation that exists for the consumer within the state, but the practical and administrative reality is that consumer use tax compliance is, in general, quite low and retail consumer (or at least individual retail consumer) use tax audits are not a practical solution.

In addition to confirming the in-state physical presence requirement for state sales and use tax compliance and collection, the U.S. Supreme Court in Quill also provided:

[The underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve. No matter how we evaluate the burdens that use taxes impose on interstate commerce, Congress remains free to disagree with our conclusions...Accordingly, Congress is now free to decide whether, when, and to what extent the States may burden interstate [commerce] concerns with a duty to collect use taxes.]

The Online Sales Simplification Act of 2015 [Draft] ("OSSA") and the Marketplace Fairness Act of 2015 ("MFA"), have been introduced this year as potential federal legislative solutions to this remote seller state sales and use tax collection issue. Media reports have mentioned that another proposal may be forthcoming, but a discussion draft is not currently available to the public; thus, only the two proposals (above) that are available to the public are discussed in this document and another alternative is presented.

As discussion continues around the OSSA and MFA, a few observations are noted below:

Neither proposal changes the Commerce Clause nexus standard (the current federal precedent requires physical presence in-state to be required to collect state sales and use tax).

The OSSA and MFA take different views toward contracting with and among states to authorize state collection of sales and use tax from a remote seller.

A state that is not a party to the OSSA “distribution agreement” (§2(a)) or a Streamlined Sales and Use Tax Agreement (“SSUTA”) Non-Member State that does not accept the “alternative” in the MFA (§2(b)), is not authorized (by either proposal), to collect state tax from a remote seller.

Neither proposal preempts state law; thus, current state law and precedent regarding click-through nexus appear to remain unchanged (but that is not free from ambiguity, based on the point above).

A uniform solution for state sales and use tax collection from a foreign remote seller is needed.

It is not clear why the Commerce Clause nexus standard is not being squarely addressed for a state and a remote seller, in the same manner, or changed by these proposals. Leaving the federal Commerce Clause nexus precedent unchanged (currently requiring physical presence in-state) for a remote seller and authorizing, separately, a contractual group of states to collect tax from a remote seller who is not required to pay tax, unless the Commerce Clause nexus standard is changed, could lead to controversy.

For example, MFA §2 provides authorization for a state to require a remote seller to collect and remit sales and use taxes. MFA §3 follows that authority and, separately, confirms that the potential legislation (as currently drafted) “shall not be construed to create any nexus or alter the standards for determining nexus between a person and a State or locality.” Quill currently provides that a remote seller with no in-state physical presence lacks “the substantial nexus” required by the Commerce Clause and is “free from state-imposed duties to collect sales and use taxes.” It stands to reason that a state may believe it should be authorized to collect something from a remote seller if the MFA (as currently drafted) is enacted. However, unless the actual Commerce Clause nexus standard or federal precedent is changed, the MFA’s approach to grant sales and use tax collection authority to a state may be somewhat toothless given that, under current Commerce Clause precedent, the remote seller cannot be compelled to pay. To prevent future controversy over what is authorized by MFA §2 and what is not changed by MFA §3, clarification regarding legislative intent and plain language in the MFA is suggested. The OSSA takes a fundamentally different approach to nexus and

3 See, e.g., Direct Marketing Association v. Brohl, 2015 B.L. 55913, 191 L. Ed. 2d 97 at 102 (U.S. 2015) providing that:
   Like many States, Colorado has a complementary sales-and-use tax regime. Colorado imposes both a 2.9 percent tax on the sale of tangible personal property within the State..., and an equivalent use tax for any property stored, used, or consumed in Colorado on which a sales tax was not paid to a retailer...Retailers with a physical presence in Colorado must collect the sales or use tax from consumers at the point of sale and remit the proceeds to the Colorado Department of Revenue (Department)... But under our negative Commerce Clause precedents, Colorado may not require retailers who lack a physical presence in the State to collect these taxes on behalf of the Department...Thus, Colorado requires its consumers who purchase tangible personal property from a retailer that does not collect these taxes (a “noncollecting retailer”) to fill out a return and remit the taxes to the Department directly. [Edited; internal references and citations omitted.]
   In 2012, only 108,600 people reported untaxed online purchases, paying $5.87 million in sales tax as part of their [Michigan] tax returns. The [State] treasury estimates that represents only 1.4% of the total amount due. [Edited; emphasis added.]
5 See, e.g., Jennifer DePaul, Technology and Retirements Biggest Challenges for Agencies, Tax Officials Say, State Tax Today, 2014 STT 191-2 (Oct. 1, 2014), quoting one Tax Official as stating that “[a]t the end of the day, the use tax can’t be enforced, and agencies can’t send out auditors to taxpayers’ homes.”
11 Id. at 315.
state sales and use tax collection and is addressed in greater detail in the following discussion.

The lack of uniformity on this fundamental point regarding Commerce Clause nexus for state sales and use tax collection purposes should be clarified as the process advances toward a legislative solution. Further, given the “all or nothing” approach to authorize a state to collect tax in both the OSSA and MFA, it is foreseeable that a state (or at least a SSUTA Non-Member State) may view these federal proposals (if enacted in their current form) as economic coercion or commandment of the state legislative or administrative process.

Thus, another alternative view, focusing on “cooperative federalism” between federal and state government, may be worth considering and is presented below. First, Congress could establish a new Commerce Clause economic nexus standard for sales and use tax purposes—one that would be consistent with the current standard applied to state income taxes. This approach would establish a uniform and consistent Commerce Clause standard for both a remote seller and a state with respect to sales and use tax collection. Congress has enumerated power to limit or expand Commerce Clause nexus standards and has previously exercised Commerce Clause authority in this area. Second, Congress could exercise Commerce Clause authority and establish a federal clearinghouse (OSSA concept) and federal streamlined compliance procedures (SSUTA concepts) as a combined solution that is less burdensome on interstate commerce than compliance with existing state law (to combine the productive efforts advanced to date on this topic and, at the same time, recognize that there is still significant work to be done). However, this federal process would be elective and the seller could still follow state law for compliance.

Then, assuming the alternative above, all remote sellers (foreign and domestic; that have contact with a state sufficient to satisfy the Due Process Clause and, thus, subject to state sales and use tax collection) have a choice: either (1) address relevant state sales and use tax compliance and collection under existing (or as modified and effective at a later date) state law, including a state’s specific procedures or the SSUTA procedures where relevant or (2) follow the new (to be established) streamlined federal approach. The U.S. Constitution provides Congress with enumerated power and authority to make necessary and proper laws in this regard and to implement that authority.

An overview of selected technology-related developments and relevant state tax economic implications are included in the following discussion. Guidance regarding separation of power follows as well as state law examples addressing taxable cloud collaboration offerings in the marketplace today. The examples, focused on taxable technology offerings under state law, and the differences in interpretation (on the same or very similar facts) between SSUTA Member States and, additionally, SSUTA Non-Member States, highlight different sovereign state tax laws and current interpretations.

Recognizing the size and scale of cloud-related economic activities in the marketplace today, as well the fact that significant taxable offerings are being provided to customers in many states where the seller has no physical presence in-state, a reasonable assertion could be made that (at least for cloud collaboration and technology) there is no longer a rational basis for having a physical presence requirement in-state for state sales and use tax collection. Specifically, in that industry, taxable offerings are purposefully directed at customers within a state (a Due Process consideration) and substantial economic activity is carried on in that state (a Commerce Clause consideration) through a high-speed Internet connection with a remote seller who has no physical presence in that state. Thus, supporting the first point in this alternative federal legislative solution, the Commerce Clause nexus standard should be changed (physical presence should no longer be required) as taxable technology applications and consumption patterns in a state (including consumer use of the Internet for retail transactions with a remote seller) today are vastly different than in the 1960’s or 1990’s (when the Commerce Clause substantial nexus federal precedent was established and confirmed). Finally, this discussion addresses the current federal legislative proposals and suggests a path forward including a “one-click” or centralized solution for state sales and use tax compliance to reduce burdens on interstate commerce.

Introduction and Relevant Economics

In light of the guidance and information above, the issue of state sales and use tax collection from a remote seller, Commerce Clause nexus, and potential Congressional intervention, is not new. However, recent technology advancements and shifts in consumer behavior (including increased usage of the Internet to purchase and consume taxable goods and services) are changing the economics and dialogue regarding the significance of the situation to the states.

Reasonable minds may disagree about the current economic magnitude of the remote seller sales and use tax collection issue. However, at least to set a baseline

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13 In this case, the financial “inducement” Congress has chosen is much more than “relatively mild encouragement”—it is a gun to the head.


for discussion, a 2009 Report from The University of Tennessee provides the following data points:

- Table 5: Total State and Local Sales and Use Tax Revenue Losses from E-Commerce Sales (Baseline Scenario) were estimated at more than $11 billion for 2012.

- The top 5 states, based on the highest estimated sales and use tax dollar losses for 2012, include: California, Texas, Florida, New York, and Illinois.
- Those 5 states, in the aggregate, represent nearly $5 billion of the 2012 estimated losses.
- Table 6: Total State and Local Sales and Use Tax Revenue Losses from E-Commerce Sales as a percentage of 2007 Sales and Use Tax Collections (Baseline Scenario) were estimated to be approximately 3.8% for 2012.

- The top 5 states, based on the highest percentage of total sales and use tax collection losses for 2012, include: Louisiana, Illinois, Nevada, Kansas, and Tennessee.

These data points provide some indication of the remote seller sales and use tax collection issue and corresponding state budgetary implications. Other reports also confirm estimated annual sales and use tax revenue collection losses, more recently, at $1 billion a year in California and, additionally, $1 billion a year in Illinois. Separately, in light of the states and information identified above, it may be interesting to note that state individual income tax collections also went up (in 2013, as compared to 2012) 10.7% in Louisiana, 21.4% in California, and 44.2% in Tennessee. While a direct correlation cannot be drawn from sales tax that can’t be collected from a remote seller without a physical presence in-state to increases in taxes that can be collected from state taxpayers, there is at least some relationship between those two as states are required to balance their budgets each year and tax revenue has to come from somewhere.

The economic point here is that the amount of state sales and use tax revenue that is not being collected from remote sellers is significant. Reasonable minds may disagree about the specific amount and the corresponding in-state tax increases, but based on the following information, it is unlikely that the economic impact will decrease, and may substantially increase, in future periods without federal legislative intervention. Economic trends, technology, and changes in relevant facts matter (or may at least influence policy, choices, and action). Thus, the following facts are included:

- Sales and use tax collections were approximately 30% of total state tax collections in 2013.
- “The United States isn’t ‘going digital’—it has already gone” and the related digital products and services are subject to a retail sales and use tax in many (but not all) U.S. States.

We are entering a new age of targeted advertising and selling products online (or at least as compared to 1992, when Quill was decided);
- In 2007 about 3% of all retail sales took place through the Internet; in 2013 that percentage reached 6%; within 10 years online/Internet sales may be 25-30% of all retail sales.

- “We are on the cusp of the mobile-first era” and mobile commerce is poised to eclipse traditional online/Internet spending (new research shows mobile-commerce growing at nearly three times the rate of overall electronic-commerce).

The following discussion addresses sovereign state rights to levy, assess, and collect state tax within a state’s jurisdiction. The scope of a state’s authority to collect tax due from a remote seller in interstate commerce has been limited by Commerce Clause precedent and, thus, the balance between federal and state author-

18 Also, for comparative purposes in light of relevant legislative proposals, it is worth specifically noting that to date, 24 states have adopted the SSUTA and those states represent less than 1/3 of the population in this country (see http://www.streamlinedsales.tax.org/index.php?page=About-Us; last visited Mar. 17, 2015). Of the states identified above, Tennessee is an Associate Member SSUTA State; Kansas and Nevada are Full Member SSUTA States; California, Texas, Florida, New York, Illinois, and Louisiana are not SSUTA Member States.
19 See California State Board of Equalization, Revenue Estimate: Electronic Commerce and Mail Order Sales, Rev. 8/13, p. 1; id., Total State Use Revenue Losses $1,012 Million, Fiscal Year 2012-2013, at http://www.boe.ca.gov/legdiv/pdf/e-commerce-08-21-13f.pdf.
22 See, id. Figure 1. Total State Tax Collections by Category (in that report) indicates that “General sales and gross receipts taxes” represent 30.1% of Total State Tax Collections in 2013.
24 Jennifer Van Grove, Facebook Hopes to Attract More Revenue With Targeted Ads, The Street.com (Feb. 20, 2015), at http://www.thestreet.com/story/13051938/1/facebook-hopes-to-attract-more-revenue-with-targeted-ads.html. “Facebook is helping big retailers target their ads more effectively to the social network’s 1.39 billion monthly users.” The new advertising platform will allow retailers “to upload their entire catalog of merchandise onto the site and target different users with specific products” and be available on both mobile and desktop devices. Facebook is also “experimenting with ‘buy buttons’ to encourage spur-of-the-moment, in-stream purchases with a single click.” This advertising platform is not being sold “strictly as a last-click tool” but facilitating a retail sale “directly and entirely attributed to a click from a Facebook ad.”
26 Business Wire, Inc., Technology Writers/Business Editors, Mobile Commerce Poised to Eclipse Traditional Online Spending; China, Turkey and United Arab Emirates Dominate in Smartphone Commerce (based on PayPal Report; Feb. 18, 2015), at http://www.marketwatch.com/story/mobile-commerce-poised-to-eclipse-traditional-online-spending-2015-02-18. “‘We are on the cusp of the mobile-first era,’ said Anuj Nayar, senior director of global initiatives for PayPal. ‘At PayPal we’ve seen our mobile growth rise from less than one percent of our payment volume in 2010 to more than 20 percent in 2014.’ ”
ity on this point is relevant with respect to the scope of any potential federal legislative solution. Therefore, a brief overview of separation of power is provided before addressing state tax law, nexus, and potential solutions.

**Separation of Power**

Our government structure, and the balance between federal and state authorities (subsequently discussed in more detail, regarding state tax collection), reflects that the:

National Government possesses only limited powers; the States and the people retain the remainder...In this case we must again determine whether the Constitution grants Congress powers it now asserts, but which many States and individuals believe it does not possess. Resolving this controversy requires us to examine both the limits of the Government’s power, and our own limited role in policing those boundaries.27

It is clear that the power of Congress to regulate interstate commerce is expansive.28 However, Congress does not possess a federal “police power” to regulate in areas reserved to the states and the people.29 This distinction is basic, fundamental, and “like the air around us . . . easily overlooked.30

Thus, the discussion regarding “whether, when, and to what extent the States may burden interstate [commerce] concerns with a duty to collect [sales and] use taxes”,31 requires a bit more consideration to address the scope of authority in the Commerce Clause32 and the Tenth Amendment33 to the U.S. Constitution in advance of a potential legislative solution. The U.S. Supreme Court has provided, as relevant:

In a case like these, involving the division of authority between federal and state governments, the two inquiries are mirror images of each other. If a power is delegated to Congress in the Constitution, the Tenth Amendment expressly disclaims any reservation of that power to the States; if a power is an attribute of state sovereignty reserved by the Tenth Amendment, it is necessarily a power the Constitution has not conferred on Congress.34

The Commerce Clause “substantial nexus” precedent (followed in Quill; currently requires a seller’s physical presence in the customer’s state before the seller can be required to collect sales and use tax) “is not, like due process ‘minimum contacts’ requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce.”35 To the extent that the collection of the state sales and use tax is not an undue burden on interstate commerce (and specifically, not limited by Quill or other relevant authority; then, as a mirror image) it is not, under this precedent, limited by the Commerce Clause and the state tax authority may collect it.

The physical presence limitation on collection of sales and use tax in the context of interstate commerce, above, is materially distinguishable from affirmatively granting Congress the power to levy and assess state tax or modify substantive state tax law and policy.36 Specifically, the sovereign power of a state to levy and assess tax within its jurisdiction is not altered by the Commerce Clause; only the state’s tax collection power is limited to the extent that sales and use tax collection is deemed to be an undue burden on interstate commerce. This point, on principle, is significant in advance of considering federal legislative solutions that may be contemplated.

To distinguish appropriate limitation on “collection” of state sales and use tax under the Commerce Clause from “levy” or “assessment” of state taxes reserved to the state by the Tenth Amendment, it is important to recognize the difference and separate meaning of each of these terms as recently explained by the U.S. Supreme Court:

[O]ne might look to contemporaneous dictionaries, which defined “levy” as the legislative function of

27 NFIB, 132 S. Ct. 2566, 2577 (2012); edited, internal citations omitted.
29 Congress may regulate “the channels of interstate commerce,” “persons or things in interstate commerce,” and “those activities that substantially affect interstate commerce.” [. . .] The power over activities that substantially affect interstate commerce can be expansive.

30 Edited; internal citations omitted.
31 Id.
32 The States thus can and do perform many of the vital functions of modern government—punishing street crime, running public schools, and zoning property for development, to name but a few—even though the Constitution’s text does not authorize any government to do so. Our cases refer to this general power of governing, possessed by the States but not by the Federal Government, as the “police power.”
33 Id.
34 This case concerns two powers that the Constitution does grant the Federal Government, but which must be read carefully to avoid creating a general federal authority akin to the police power. The Constitution authorizes Congress to “regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.” Art. I, §8, cl. 3.

36 Quill Corp v. North Dakota, 504 U.S. 298, 313 (1992); emphasis added.
38 Indeed, the Constitution did not initially include a Bill of Rights at least partly because the Framers felt the enumeration of powers sufficed to restrain the Government. As Alexander Hamilton put it, “the Constitution is itself, in every rational sense, and to every useful purpose, A BILL OF RIGHTS.” The Federalist No. 84, p. 515 (C. Rossiter ed. 1961). And when the Bill of Rights was ratified, it made express what the enumeration of powers necessarily implied: “The powers not delegated to the United States by the Constitution, and provided by it to the States, or reserved to the People.” U.S. Const., Amdt. 10.
39 The Federal Government has expanded dramatically over the past two centuries, but it still must show that a constitutional grant of power authorizes each of its actions. The same does not apply to the States, because the Constitution is not the source of their power.

30 Edited; emphasis added; internal citations omitted.
34 Quill Corp. v. North Dakota, 504 U.S. 298, 318 (1992); edited; emphasis added.
35 U.S. Const. art. I, §8, cl. 3. Congress has the power to “regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes; . . .”
36 U.S. Const. amend. X. “The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.”
laying or imposing a tax and the executive functions of assessing, recording, and collecting the amount a taxpayer owes...But under any of these definitions, “levy” would be limited to an official governmental action imposing, determining the amount of, or securing payment on a tax.

Finally, “collection” is the act of obtaining payment of taxes due...It might be understood narrowly as a step in the taxation process that occurs after a formal assessment. Consistent with this understanding, we have previously described it as part of the “enforcement process...that ‘assessment’ sets in motion”...“Collection” might also be understood more broadly to encompass the receipt of a tax payment before a formal assessment occurs...Either way, “collection” is a separate step in the taxation process from assessment and the reporting on which assessment is based.38

Thus, a distinction is made here (and amplified in the following discussion) with respect to sovereign state law, including the state legislative process to impose and define the parameters of state taxation, and, separately, procedural considerations including collection (and subsequent audits and appeals) of state sales and use tax in interstate commerce. To confirm:

That the taxing power of a State is one of its attributes of sovereignty; that it exists independently of the Constitution of the United States, and undervied from that instrument; and that it may be exercised to an unlimited extent upon all property, trades, business, and avocations existing or carried on within the territorial boundaries of the State, except so far as it has been surrendered to the Federal government, either expressly or by necessary implication, are propositions that have often been asserted by this court. And in thus acknowledging the extent of the power to tax belonging to the States, we have declared that it is indispensable to their continued existence.39

**State Law and Taxation of Cloud Collaboration**

Variations among different state’s sales and use tax laws are highlighted as applied to newer and advanced technology offerings including tangible personal property, software, digital goods/services, communications, and other taxable services in interstate commerce. Additionally, the labels “cloud computing”40 and “software as a service”41 and have led, in some instances, to general views regarding taxation that may be misleading or inaccurate. Several state specific rulings and guidance in this area are noted below. The rationale for providing a very high-level survey of state tax authorities in this area (beyond traditional tangible personal property ordered through the Internet from a remote seller) is to provide an overview of the realities in the marketplace relevant to sales and use tax collection today.

To take a glimpse into the future (regarding remote seller nexus concepts below; given the technology advancement and applications today), virtual reality has been described as:

“[A] way of enabling people to participate directly in real-time, 3-D environments generated by computers.” Virtual reality involves the user’s immersion in and interaction with a graphic screen/s. Using 3-D goggles and sensor-laden gloves, people “enter” computer-generated environments and interact with the images displayed there. “Imagine the difference between viewing fish swimming in an aquarium and donning scuba gear to swim around them.” That’s the sensory leap between regular computer graphics and virtual reality.42

Telepresence (which may be remote—for the seller and consumer), foreshadowing the state tax law applications (subsequently noted) includes:

[V]ideoconference systems intended to make participants forget they’re in different places. The people captured onscreen are life-size—and life-like: Lips move in perfect sync with the video. There’s eye contact. And no audio lag. To enhance that feeling of togetherness, says BusinessWeek, each vendor installs conferencing rooms that look alike, with the same tables and wall colors. As for price, brace yourself.43

[Edited, above; vendor brand names, not directly rel-

voice, data, audio, video or any other information or signals to a point, or between or among points.”

When cloud-computing is used to route such electronic signals, customer charges are, by definition, charges for telecommunications or ancillary services. These services are taxable in Kansas. Such services charges are mischaracterized by legal and technical arguments that assert they are nontaxable customer charges for: (1) remote access to pre-written software; (2) Internet access; (3) the use of hosted software; (4) software delivered in or outside Kansas; (5) remote software management; (6) SaaS or PaaS; (7) remote application services; or (8) any other terms used to describe customer access to and use of remote software and servers. Emphasis added.

42 See, e.g., Commonwealth of Massachusetts Department of Revenue Letter Ruling 12-10 Screen-Sharing Software and the Massachusetts Sales/Use Tax, (Sep. 25, 2012), which provides:

Charges for prewritten software, whether it is electronically downloaded to the customer or accessed by the customer on the seller’s server (including the “Software as a Service” business model) are generally taxable. The marketing description of a product as “software-as-a-service” does not determine taxability of that product, nor does the fact that customers do not download software or otherwise install software on their own computers or other devices. Emphasis added.


40 See, e.g., Kansas Department of Revenue Ruling Number: P-2013-001, Charges for Telecommunications Services Subject to Sales Tax (Jul. 3, 2013), State Tax Today, 2013 STT 139-9 (Jul. 19, 2013), which provides: [...] The term “cloud-computing” means different things to different people... Cloud-computing is commonly used to provide hosted application services, such as SaaS (Software as a Service) or PaaS (Platform as a Service), that provide remote access to software and data stored on the “cloud” provider’s servers. However, cloud-computing is also used to route “electronic...
evant, are mentioned regarding current availability—several hundred thousand dollar investment, plus significant monthly service charges.

The state sales and use tax authorities addressing a “bundled” retail offering (including hardware [traditional tangible personal property], software, digital content, and services) as described above are limited. To state what may be obvious, technology and commercial applications are changing faster than state and local sales and use tax law. However, this type of technology-oriented fact pattern presents a realistic view of the significance of remote seller nexus (specifically, whether an in-state physical presence requirement is relevant and necessary with respect to interstate commerce in a digital and electronic age) when all or a significant portion of cloud-based retail offerings may be provided and accessed through a high-speed connection to the Internet.

“Cloud computing”44 is “disrupting traditional IT” in the global marketplace in a business and economic sense; specifically, based on a recent report, Internet cloud infrastructure spending is predicted to go from $16 billion in 2014 to $43 billion by 2018. Further, based on a recent news release (reflecting data for the 3rd quarter of 2014), the leading provider of cloud services in this country recently had revenue growth of 55% (year over year), a 27% market share, and over $1 billion in sales in that quarter (those sales were nearly as much revenue as the next five companies, combined).46 The world’s largest e-commerce company (a foreign remote seller) appears to be entering the U.S. cloud technology marketplace too.47 With that background, the following state tax rulings provide some illumination regarding relevant considerations with respect to retail “cloud collaboration” offerings in the marketplace.

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Cloud computing has revolutionized information technology (IT). The technique leverages a network of remote servers hosted on the Internet to store, manage, and process data, rather than a local server or a personal computer. By enabling on-demand delivery of IT resources and applications via the Internet with pay-as-you-go pricing, cloud computing has paved the way for a slew of efficient, inexpensive services. You couldn’t ask for a technology more tailor-made for private equity investors, whose appetite for efficient, cost-effective strategies is legendary.


The enterprise IT market is in year six or seven of a 20-plus year cloud computing cycle. The technique leverages a network of remote servers hosted on the Internet to store, manage, and process data, rather than a local server or a personal computer. By enabling on-demand delivery of IT resources and applications via the Internet with pay-as-you-go pricing, cloud computing has paved the way for a slew of efficient, inexpensive services. You couldn’t ask for a technology more tailor-made for private equity investors, whose appetite for efficient, cost-effective strategies is legendary.


47 Paul Carsten and John Ruwitch, Alibaba Hiring in Amazon, Microsoft Backyard as US Cloud Unit Expands, (Mar. 12, 2015) at http://www.reuters.com/article/2015/03/12/alibaba-group-hiring-usa-idUSL4N0W82X820150312

At least eight state tax administrative agencies have provided private letter rulings (available to the public, in redacted form and cited below48 addressing the application of their specific state’s sales and use tax law to the same (or a nearly identical) “cloud collaboration” retail offering provided to customers in those specific states. While the labels used in each state’s specific ruling vary, each fact pattern included the same specific seven retail options to customers (either in a single bundle or any variation among the options available based on customer choice; as a back-office add-on to telecommunications equipment including: voice, video, messaging, presence, audio conference, web conferencing, and mobility services provided through an Internet-based application. The practical business (and state and local sales and use tax) point is that a customer can either purchase this type of bundled “offering” from a retail vendor or, alternatively, make taxable retail purchases of hardware, software, and services for use at a customer location in a particular state to operate customer’s communication network.

Specifically, the taxable receipts from the retail cloud-based offering noted above were characterized (by each state tax agency; only intended as examples to make a point regarding differences in state tax law as applied to the same or similar fact pattern; not a comprehensive list) as from the following:

- Tangible personal property (Utah and South Carolina)
- Communications Services (Virginia)
- Telecommunications or Ancillary Services (Kansas, Missouri, Tennessee)
- Automatic Data Processing Services (Ohio)

To confirm, each state’s tax agency did an analysis of the same/similar facts provided and reached four materially distinct conclusions (above; based on their state’s tax law) regarding characterization of the taxable transaction supporting the conclusion that the relevant retail transaction was subject to tax in their state. Considerations (not specifically addressed in these rulings, of a
comparative nature—between these different state views) relevant to state and local tax rates, sourcing taxable receipts (destination v. origin implications, when blended with bundled Mobile Telecommunications Services), and Streamlined Sales Tax States (which were not uniform on this fact pattern; above) are noted briefly in the following discussion relating to current federal proposals to address interstate tax compliance. Each ruling addressed the nexus question a bit differently (and in some cases, not at all, as a ruling on that point was not specifically requested); however, it appears that the remote vendor would not have a physical presence in any of the eight states identified. To be direct, there’s no business requirement that a remote seller would need a physical presence anywhere in the U.S. to provide this type of taxable retail marketplace offering to customers in every state in this country.

While the words “telepresence” and “virtual reality” (as used in this discussion), are not used in the rulings identified above, as those were not the facts addressed, a subsequent analysis of those services in these states may lead to similar conclusions as voice, video, messaging, web-conferencing, and mobility applications through the Internet (included and addressed in those rulings) are certainly integrated (or at least relevant, from a state tax analytical perspective) in telepresence and virtual reality retail applications. Thus, the substantive state tax views (sovereignty; differences) above may be helpful to recognize when crafting a federal legislative solution (which may or may not address traditional sourcing rules for sales and use tax purposes) aimed at remote seller nexus, process standardization (to reduce the burden of compliance in interstate commerce), and state sales and use tax collection.

Nexus

A clear statement is needed from Congress to add “substantial nexus” considerations flowing from federal Commerce Clause precedent. Specifically, under the broad authority granted to Congress to regulate interstate commerce (previously noted), guidance is needed regarding whether or not physical presence should continue to be required for remote seller sales and use tax purposes; or if the time has come to eliminate the current federal physical presence requirement in this context. A choice not to address this threshold point, in either the OSSA or MFA, adds complexity, not simplicity or uniformity, to the analysis and potential solutions as subsequently discussed.

As addressed in Quill, the U.S. Supreme Court confirmed that the Due Process Clause and Commerce Clause considerations are analytically distinct and, additionally, that “notice” or “fair warning” are “the analytic touchstone of due process nexus analysis.” Thus, separate from the Due Process Clause:

The Commerce Clause and its nexus requirement are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy. Under the Articles of Confederation, state taxes and duties hindered and suppressed interstate commerce; the Framers intended the Commerce Clause as a cure for these structural ills. See generally The Federalist Nos. 7, 11 (A. Hamilton). It is in this light that we have interpreted the negative implication of the Commerce Clause. Accordingly, we have ruled that that Clause prohibits discrimination against interstate commerce...and bars state regulations that unduly burden interstate commerce.

In Quill, the U.S. Supreme Court followed precedent by guiding that Bellas Hess “stands for the proposition that a vendor whose only contacts with the taxing State are by mail or common carrier lacks the ‘substantial nexus’ required by the Commerce Clause.” Recently, in a concurring opinion, U.S. Supreme Court Justice Kennedy specifically stated that the holding in Quill is “now inflicting extreme harm and unfairness on the states” and “should be left in place only if a powerful showing can be made that its rationale is still correct.” Justice Kennedy also stated that, as a result of the Internet, “a business may be present in a State in a meaningful way without that presence being physical in the traditional sense of the term.”

Historical facts have changed since the 1967 Bellas Hess decision (the guiding precedent in Quill) and electronic commerce has evolved into a daily part of life today that did not exist 40-50 years, or even a decade ago. In just the past few years, main stream technology has advanced so far that many people no longer have significant application software (something they used to buy, shrink-wrapped and sealed, in a box at a retail store for word processing, spreadsheets, calendar applications, etc.) stored on their computer; they access that technology, software, and various digital products...of fair play and substantial justice.’ ” In that spirit, we have abandoned more formalistic tests that focused on a defendant’s “presence” within a State in favor of a more flexible inquiry into whether a defendant’s contacts with the forum made it reasonable, in the context of our federal system of Government, to require it to defend the suit in that State. In Shaffer v. Heitner, . . . the Court extended the flexible approach that International Shoe had prescribed for purposes of in personam jurisdiction to in rem jurisdiction, concluding that “all assertions of state-court jurisdiction must be evaluated according to the standards set forth in International Shoe and its progeny.” Applying these principles, we have held that if a foreign corporation purposefully avails itself of the benefits of an economic market in the forum State, it may subject itself to the State’s in personam jurisdiction even if it has no physical presence in the State.

Edited; internal citations omitted; emphasis added.

Under Complete Auto’s four-part test, we will sustain a tax against a Commerce Clause challenge so long as the “tax [1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State.”

50 Id. at 307 provides:
Our due process jurisprudence has evolved substantially in the 25 years since Bellas Hess, particularly in the area of judicial jurisdiction. Building on the seminal case of International Shoe . . . we have framed the relevant inquiry as whether a defendant had minimum contacts with the jurisdiction “such that the maintenance of the suit does not offend ‘traditional notions
through a high-speed Internet connection, using mobile hardware (phone, laptop, tablet, smart-watch, etc.), from a remote seller that may be located anywhere in the world (and, importantly, in this context, that remote seller may have no physical presence in the state where the technology offering is purchased, downloaded, or used). Thus commerce using the Internet (online ordering of retail goods) as well as offerings and consumption of taxable products that are entirely digital (voice over IP telephone, web-conferencing, and a whole generation of new technology products and applications) have changed the world that we live in and the current federal limitation on state taxation, specifically requiring a physical presence in-state to be subject to sales and use tax collection obligations, should conform to the modern age.

A clear statement is needed from Congress to confirm that, under Commerce Clause authority, a physical presence should no longer be required for state sales and use tax purposes and, thus, state sales and use tax obligations that do not unduly burden or discriminate against interstate commerce should not be prohibited. If the physical presence precedent under the Commerce Clause is not changed, the subsequent (proposed) effort to reduce burdens on interstate sales and use tax compliance may have reduced benefit as, is the case today, a remote seller without an in-state physical presence cannot be forced to collect and pay state sales and use tax under the authority of Quill. Also, to confirm, no change is suggested with respect to Due Process requirements and they remain analytically separate and distinct from the Commerce Clause.

To clarify, assuming a nexus change is made under Commerce Clause authority—to an economic (not physical) presence standard (which is suggested), the “substantial nexus” analysis would continue to focus on all of the connections with the state asserting jurisdiction to impose sales and use tax. The term “substantial” still modifies the relevant connection and, thus, not just any nexus will cross this threshold focused on limiting undue state burdens on interstate commerce. A qualitative as well as quantitative Commerce Clause analysis based on specific facts and circumstances would be relevant. Thus, for the nexus to be substantial and uphold the application of state sales and use tax, all the connections with the forum state would have to be substantial to satisfy Commerce Clause considerations.

In contrast, minimum contact (a different standard; distinguished from substantial nexus) will satisfy Due Process concerns (focused on notice and fundamental fairness; physical presence not currently required) when a remote seller purposefully avails itself of the benefits of an economic market in the forum state. So the Due Process clause remains highly relevant, to address principles of fundamental fairness and notice to the remote seller, and the Commerce Clause authorities would continue to require that the nexus with the state be substantial to uphold a particular state’s sales and use tax law and collection obligations on a remote seller.

A recent Congressional Research Service Report provides a concise and thoughtful summary of the evolution of state sales and use tax law in light of the decision in Quill. That analysis will not be repeated here, but three observations are made below with respect to several cases and state laws addressed in that report.

First, the U.S. Supreme Court recently held that the Tax Injunction Act does not bar a suit to enjoin the enforcement of the (relatively new) Colorado remote seller notification provisions (and reversed and remanded the case to the U.S. Court of Appeals for the Tenth Circuit). The Colorado remote seller provisions are unique in that they do not require the remote seller to collect or remit sales tax to the state but do incorporate, by cross reference, the sales tax definition of a “retailer” subject to those requirements and then establish a new information reporting requirement for the remote seller both to their customers in Colorado and the
The merits of the Colorado remote seller information reporting requirements, including Commerce Clause and Due Process considerations, were not addressed by the U.S. Supreme Court as the appellate judicial question presented was procedural, not substantive, in nature.

Second, New York State’s expansion of the statutory definition of a “vendor,”62 in what is now generally referred to in the field of state taxation as a “click-through” nexus provision for sales and use tax purposes, is changing the landscape as other jurisdictions have followed this type of state legislative approach. In 2013, the Court of Appeals of New York (the highest New York State Court) provided:

Plaintiffs challenge Tax Law § 1101 (b) (8) (vi) (the Internet tax), alleging that it is unconstitutional on its face because it violates the Commerce Clause by subjecting online retailers, without a physical presence in the state, to New York sales and compensating use taxes. They also maintain that the Internet tax violates the Due Process Clause by creating an irrational, irrebuttable presumption of solicitation of business within the state. We reject plaintiffs’ facial challenges.63

The New York Court relied on prior New York State precedent and looked to economic activities performed in New York State (by the New York resident website owner) on the remote seller’s behalf to address the physical presence requirement (as the remote seller did not have a direct physical presence in the state) in addressing substantial nexus for purposes of the federal Commerce Clause analysis (as interpreted and applied by this state court). In upholding this statute, New York State legislation appears to accomplish indirectly, through a referral arrangement and a “click” on an Internet link, what the state could not do directly, in light of Quill’s physical presence requirement, to subject a remote seller to state sales and use tax collection and reporting obligations. “While other states have adopted laws similar to New York’s, it does not appear that any court has examined the constitutionality of those laws.”64

Illinois may provide a forum to test the constitutionality of a click-through sales and use tax nexus provision. As background, in 2013, the Supreme Court of Illinois (addressed a related fact pattern under what is now prior sales and use tax law) provided:

The plaintiff, Performance Marketing Association, Inc., filed a complaint seeking declaratory and injunctive relief against the defendant...Director of the Illinois Department of Revenue. Plaintiff alleged that portions of Public Act 96-1544, a so-called “click-through” nexus law, were preempted by federal law and violated the commerce clause of the United States Constitution. The circuit court of Cook County agreed with both propositions and entered summary judgment in plaintiff’s favor. Defendant appealed directly to this court. Ill. S. Ct. R. 302(a) (eff. Oct. 4, 2011). Because we agree with the circuit court’s conclusion that the relevant portions of Public Act 96-1544 are preempted by federal law, we affirm the judgment of the circuit court.65

The Illinois State Supreme Court analyzed the Internet Tax Freedom Act and the positions of the parties to reach the conclusion that the statutory provision in Illinois imposed a tax on electronic commerce that was not also applied to other remote vendors promoting sales activity in Illinois through print or over-the-air broadcasting. Thus, the click-through provision was found to be a discriminatory tax within the meaning and prohibition in the Internet Tax Freedom Act66 and, therefore, preempted by federal law.

Illinois changed its state sales and use tax nexus provisions after the decision above and, effective January 1, 2015, provides that a remote seller required to register, collect, and remit sales/use tax in Illinois has expanded and includes the following:

[T]he out-of-state retailer has a contract with a person in Illinois;

61 Colo. Rev. Stat. §39-21-112(3.5) (c)(i), (il), address notification to Colorado customers and Department of Revenue, respectively. Additionally, Colo. Rev. Stat. §39-21-112(g)(c)(il) establishes an electronic reporting requirement to the Department of Revenue as well.
62 NY CLS Tax §1101 (b)(8)(vi) provides that the term “vendor” (for New York State sales and use tax purposes) includes a person who solicits business through independent representatives; specifically:
[A] person making sales of tangible personal property or services taxable under this article (“seller”) shall be presumed to be soliciting business through an independent contractor or other representative if the seller enters into an agreement with a resident of this state under which the resident, for a commission or other consideration, directly or indirectly refers potential customers, whether by a link on an Internet website or otherwise, to the seller, if the cumulative group of receipts from sales by the seller to customers in the state who are referred to the seller by all residents with this type of agreement with the seller is in excess of ten thousand dollars during the preceding four quarterly periods... This presumption may be rebutted by proof that the resident with whom the seller has an agreement did not engage in any solicitation in the state on behalf of the seller that would satisfy the nexus requirement of the United States constitution during the four quarterly periods in question. Edited; emphasis added.
66 The Internet Tax Freedom Act (ITFA) (47 U.S.C. §151 note (2014)) provides:
Sec. 1101. Moratorium. (a) Moratorium. No State or political subdivision thereof may impose any of the following taxes during the period beginning November 1, 2003, and ending October 1, 2015:
(1) Taxes on Internet access. (2) Multiple or discriminatory taxes on electronic commerce.
Sec. 1105. Definitions. For the purposes of this title:
(2) Discriminatory tax. The term ‘discriminatory tax’ means—(A) any tax imposed by a State or political subdivision thereof on electronic commerce that—....(iii) imposes an obligation to collect or pay tax on a different person or entity than in the case of transactions involving similar property, goods, services, or information accomplished through other means;
(3) Electronic commerce. The term ‘electronic commerce’ means any transaction conducted over the Internet or through Internet access.
under the contract, the person in Illinois refers potential customers to the retailer and the retailer pays to the person in Illinois a commission or other consideration based on the sale of tangible personal property by the retailer;

- the person in Illinois provides to the potential customers a promotional code or other mechanism that allows the retailer to trace the purchases made by these customers;
- the retailer made cumulative gross sales of $10,000 during the preceding four quarterly periods to customers referred by persons located in Illinois, regardless of the location of the customers.

If all of these conditions are met, the retailer is presumed to be maintaining a place of business in Illinois and is required to register and to collect and remit Use Tax on all of its sales to Illinois customers.

As discussed in this section, nexus standards are significant as applied to state sales and use tax. Given state economic pressure to collect taxes due in interstate commerce, state legislative approaches appear to push the boundaries established by the U.S. Supreme Court in Quill. A change to the Commerce Clause nexus standard to eliminate the current physical presence precedent may eliminate significant controversy in this area and would establish a uniform standard applicable in international and interstate commerce with respect to retail sale of taxable products and services to customers within a particular state.

Moving Forward

As previously stated, the shape and scope of federal guidance on this remote seller state sales and use tax collection issue is (and reflects) a policy choice for Congress. This discussion continues with a proactive view to support getting federal legislation enacted to address this issue. At the outset, several guiding principles from the U.S. Supreme Court must be recognized as relevant to federal action:

- “Legislative novelty is not necessarily fatal; there is a first time for everything.”
- “[T]he Constitution allocates to Congress the power ‘to regulate Commerce [with foreign Nations, and] among the several States.’ Art. I, §8, cl. 3.”

A conceptual distinction could be made regarding whether Commerce Clause authority should be exercised in this area regarding the nexus standard and application with a principle-oriented solution or a rule-based requirement. For example, OSSA §5 (7) defines and prescribes “physical presence” in a rule-based manner, beyond a common understanding of those terms, with specific dollar thresholds, employee activity considerations, and other requirements. That approach may facilitate creative planning around or into “statutory” physical presence to reduce the effective rate of state and local sales and use tax applied to a retail sale by a sophisticated nationwide or foreign remote seller.

MFA §3 (b) specifically provides that the “Act shall not be construed to create any nexus or alter the standards for determining nexus between a person and a State or locality.” Thus, while MFA §4 (5) may define a “remote sale,” it does not change the Quill precedent applicable to the remote seller (thus, a remote seller without in-state physical presence would still, apparently, not be required to collect or pay the tax), irrespective of collection authority that may be granted to one or more states by federal contract or agreement. The difference in such “substantial nexus precedent” that continues for a seller, on one hand, and collection authority that may be granted to a state, on the other, should be harmonized in any legislative solution on this topic to mitigate potential disputes over liability for the sales and use tax and, separately, collection authority and responsibility in interstate commerce.

Transitioning to the OSSA, specifically, an example may help illustrate the sovereign state tax considerations and implications given the OSSA §2 (b) proposal


Otherwise the two-government system established by the Framers would give way to a system that vests power in one central government, and individual liberty would suffer. […] That insight has led this Court to strike down federal legislation that commandeers a State’s legislative or administrative apparatus for federal purposes.

Edited; internal citations omitted; emphasis added.


By contrast, where the Federal Government compels States to regulate, the accountability of both state and federal officials is diminished…Accountability is thus diminished when, due to federal coercion, elected state officials cannot regulate in accordance with the views of the local electorate in matters not preempted by federal regulation.

Edited; internal citations omitted; emphasis added.
to impose tax on a remote sale at the origin rate. Going back to the prior summary of state law and the state tax administrative rulings addressing cloud collaboration offerings, assume that there is a retail consumer in Kansas who uses a mobile phone to purchase and utilize the cloud-based application described in those rulings. Further, assume that the cloud-based provider has a physical presence in Utah and no other place (and that the Utah-based seller is purposefully directing those services into the Kansas marketplace so there is no Due Process obstacle in this simplified fact pattern). In Kansas, the offering is treated as a taxable telecommunications service and sourced to the customer’s place of primary use in Kansas. If the facts were reversed, with the provider in Kansas and the consumer in Utah, Utah would characterize the offering as a retail sale of tangible personal property under Utah law and specifically not the sale of telecommunications service in Utah. Both Kansas and Utah are SSUTA Full Member states.

If hybrid-origin sourcing is implemented under OSSA §2 (b), on these facts, then the Utah seller would source the receipts to Utah and apply the Utah rate of tax applicable to the sale of tangible personal property in contrast to the rate under Kansas law which would include state and local charges on telecommunications services corresponding to the customer’s place of primary use in Kansas. Thus, while a seller may comply with this OSSA hybrid-origin sourcing provision, it appears they may have, at the same time, violated the Mobile Telecommunications Sourcing Act. Given the significant use of mobile technology in the current environment, this potential inconsistency should be addressed in a manner that does not create additional complexity and risk for a remote seller.

Beyond the potential tax rate and Mobile Telecommunications Sourcing Act implications, the fundamental point (previously made in the separation of powers section of this discussion) is with respect to a sovereign state’s right to levy, assess, and collect state tax within its jurisdiction. Instead of focusing on the collection of tax from a remote seller in interstate commerce, the OSSA approach fundamentally changes state law with respect to taxation and specifically, in the prior example, changes the taxable event, including the levy, assessment, and collection of state tax on a retail transaction in Kansas, from Kansas to Utah. The potential federal authority to take that kind of state legislative action should be clearly documented in the public record supporting the proposed OSSA as it appears to cross the line into an area of power reserved to the states by the Tenth Amendment to the U.S. Constitution.

Beyond the nexus and other implications above, the “all or nothing” sales and use tax collection considerations flowing from both the MFA and OSSA merit additional attention. The context here is most readily apparent when considering a potential state challenge to either current federal legislative proposal. If, on one hand an “agreement” presents an opportunity to collect tax from a remote seller or, on the other hand, a state may not be authorized to collect any of the same tax due, that is, arguably, a “gun to the head” in this context from a state economic perspective. The bullet points at the beginning of this section provide the analytical roadmap in this area and the fundamental point, and implication here, is whether the potential federal solutions proposed could be interpreted as requiring, or economically compelling, a state to regulate according to Congress’ instructions as a condition to collect state sales and use tax due from a remote seller in interstate commerce. Creating federal incentives to encourage state and marketplace participation is a reasonable approach; however establishing a federal requirement that the States govern according to Congress’ instructions is not.

Thinking about an appropriate solution to collecting state and local sales and use tax from another perspective may be useful as well. For example, as we are certainly in a global and interconnected environment, it is worth at least exploring what is going on in the European Union (E.U.) and how that might impact both outbound and inbound retail business activity (from/to the U.S. and E.U. and vice-versa). Specifically, the E.U. recently changed its sourcing rules for taxes imposed on taxable telecommunications, broadcasting, and electronic services as of January 1, 2015 (from place of supply to place location of customer for private customers in the E.U.). The E.U. simultaneously rolled out a Mini-One Stop Shop (“MOSS”), an electronic Value- Added Tax (VAT) tool that the E.U. member states may choose to implement for their intra-E.U. and extraterritorial sales and thusly serves to simplify the process of applying VAT to intra-E.U. sales. The potential for sales and use tax rate arbitrage to take place is thusly limited to where the customer is located. 

72 Kansas Department of Revenue Ruling Number: P-2013-001, Charges for Telecommunications Services Subject to Sales Tax (Jul. 3, 2013).
75 4 U.S.C. §§116-124. These rules provide, generally, that the mobile telecommunication services are taxable at the customer’s place of primary use (defined under federal law) and at no other location.
76 New York v. United States, 505 U.S. 144, 182-183 (1992). The constitutional authority of Congress cannot be expanded by the “consent” of the governmental unit whose data remains thereby narrowed, whether that unit is the Executive Branch or the States.

State officials thus cannot consent to the enlargement of the powers of Congress beyond those enumerated in the Constitution. Indeed, the facts of these cases raise the possibility that powerful incentives might lead both federal and state officials to view departures from the federal structure to be in their personal interests...If a federal official is faced with the alternatives of choosing a location or directing the States to do it, the official may well prefer the latter, as a means of shifting responsibility for the eventual decision. If a state official is faced with the same set of alternatives—choosing a location or having Congress direct the choice of a location—the state official may also prefer the latter, as it may permit the avoidance of personal responsibility. The interests of public officials thus may not coincide with the Constitution’s intergovernmental allocation of authority. Where state officials purport to submit to the direction of Congress in this manner, federalism is hardly being advanced.

Added Tax ("VAT") clearinghouse—a new tool, to address VAT compliance—for sellers within as well as outside the E.U. (to simplify VAT compliance as there is no physical presence requirement or de minimis rule for VAT purposes).\(^{78}\) The MOSS provides an option (but not a requirement, for simplified compliance, collection, and reporting) for "both EU and non-EU businesses [to] use a web portal in the EU country where they are VAT-registered to declare and pay the VAT due in their customer’s EU country.

A transition toward a remote seller solution for state sales and use tax collection may also be leveraged from prior non-tax examples of cooperative federalism to address significant interstate commerce concerns.\(^{80}\) For example, Congress has the power to create incentives to encourage state action and, to the extent a state is unwilling or unable to address the issue, create a federal process and federal regulation as an alternative to state action to address the interstate commerce consideration. Thus, state law and legislative process is respected and, to the extent state action is not taken, compliance with federal regulation and federal procedure is appropriate in the context of interstate commerce.\(^{81}\)

Thus, a concurrent approach is presented as an option to consider (referred to as an "alternative approach" below) which would respect state law and, additionally, establish a federal and less burdensome option for a remote seller’s interstate sales and use tax compliance and collection. A proposed federal legislative solution could incorporate both a clearinghouse (OSSA) concept as well as all the efforts behind (and currently ongoing with respect to) the MFA for simplified and uniform sales and use tax compliance in interstate commerce. Explicitly allowing compliance with current state law (including the SSUTA) or a federal solution, to the extent a remote seller deems that proposed option less burdensome for their sales and use tax compliance and collection, would be consistent with Commerce Clause authority and respects state sovereignty in this context.

This type of alternative approach would also respect SSUTA contracts and agreements between sellers, certified service providers, and states for sales and use tax collection as those would remain in place and unaffected. Furthermore, experience in SSUTA jurisdictions for streamlined compliance procedures and software solutions could be leveraged and replicated in federal regulation as an option for compliance in every state, not just SSUTA Member States.

In the near term, the goal would include federal streamlined process and procedures for interstate sales and use tax compliance. A longer term goal may include a centralized technology solution conceptually similar to what has recently been done in the E.U. for VAT compliance—"one-click" and done for interstate sales and use tax would certainly reduce burdens on interstate commerce and should be feasible (recognizing the significant technology investment, design and implementation considerations, and possible cost recovery mechanisms, in future periods).

From a principles-based perspective, this type of alternative approach for remote seller sales and use tax collection solution (above) is consistent with federal guidance previously shared on this topic.\(^{82}\) The following final discussion addresses each relevant principle in this context.

**Tax Relief.** The alternative approach does not create any new or discriminatory taxes or apply solely to online or Internet sales. The streamlined federal approach would be available to all retail sellers in interstate commerce and should lead to reduced sales and use tax compliance burdens for many small and larger interstate brick and mortar retailers as well as remote sellers.

**Tech Neutrality.** The alternative approach would put all sellers on the same footing for compliance with state sales and use tax law applicable to a retail sale to a customer within a specific state regardless of the location of the seller. In-state, out-of-state, on-line, off-line, or any combination of technology channels and geography for a brick and click seller would have the same options and responsibilities for compliance and collection of state sales and use tax imposed on a retail transaction with a customer in a particular state.

**No Regulation Without Representation.** This sales and use tax collection consideration is a significant issue across the country. The alternative approach suggested would be an exercise of federal authority and regulation, voters have a voice in that federal election process, and incorporates SSUTA concepts and channels for appeal (which are still being fully developed), potentially, if necessary, into the judicial system in this country.

**Simplicity.** This is a relative concept and should be viewed from the perspective of the person or entity addressing the sales and use tax compliance obligation(s). Small business and global enterprises doing business in a particular state may have different views regarding sales and use tax compliance and undue burdens in interstate commerce. The alternative approach presented includes a longer-term "one-click" solution as a goal. If something as simple as currently filing a U.S. Individual Income Tax Return on-line is developed as a federal solution for interstate sales and use tax compliance (addressing as many jurisdictions as may be required for a

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81 Id. at 168.
seller based on retail customer locations), that would appear to address the simplicity point. In any event, a shorter-term federal goal of process standardization (without a technology portal solution) would still reduce interstate sales and use tax compliance burdens and move the needle toward simplicity in this regard.

Additionally, goals of simplicity, uniformity, and certainty are advanced by establishing an economic nexus standard for state sales and use taxation as described in the prior discussion. From a seller’s perspective, that standard would then be the same as the current standard in place for state income taxation. Importantly, having the same Commerce Clause standard for a seller and all state and local jurisdictions regarding sales and use tax collection (going forward, an economic nexus standard) will be much simpler to address and enforce, uniformly, than leaving the Quill physical presence precedent in place for a seller, allowing at least one state’s click-through nexus statute to apply (New York; a significant number of other states have similar statutes that have not yet been fully tested through the judicial system) and, separately, establishing new sales tax collection authority on a state-by-state basis, by agreement under federal law. The latter approach does not lead to certainty in the marketplace or uniformity among the states.

The alternative suggested also promotes simplicity, as compared to at least one of the current proposals, as it does not require a new series of federal definitions applicable to state sales and use taxation.

**Tax Competition.** As previously noted, U.S. businesses providing certain electronic services to customers in the E.U. are required to register, collect, and remit the applicable VAT on those retail transactions (as there is no physical presence requirement in the E.U. and there is no de minimis threshold for compliance). In contrast, current federal law provides a comparative advantage to foreign business, as a business in the E.U. with no physical presence in a U.S. customer’s state may provide similar electronic services to that customer without being required, under current federal precedent, to collect and remit state and local sales and use tax that would apply in the customer’s state (assuming the customer is in a state that taxes these services). In-state retail sellers should not continue to be disadvantaged, regarding the collection of sales and use tax, as compared to foreign and domestic remote sellers not currently required to collect state sales and use tax imposed on the retail sales of goods and other taxable offerings provided to a customer in a specific state.

The alternative suggested in this discussion proposes changing the Commerce Clause standard to an economic nexus standard to address this international and interstate commerce issue in a uniform manner for all retail sellers. That change would put foreign and domestic remote sellers on the same footing with respect to state sales and use tax collection responsibility as in-state sellers when providing the same retail goods and services to the same in-state customer. Once tax collection responsibility is addressed uniformly for all retail sales to a customer within the state, then the state can focus more appropriately on tax competition for the benefit of in-state business and people. The indirect impact of not changing the nexus standard as suggested disadvantages in-state businesses as they are required to collect state sales and use tax on a retail sale and either increase the price to customers or decrease profit to compete on price with a remote seller not collecting the state sales and use tax. The net effect is a relatively significant increase in online business and an indirect shift to increasing state tax burdens collected from in-state taxpayers (to offset sales and use tax revenue due, but uncollectible from remote sellers; noted in the prior discussion) to balance state budgets and pay for necessary state services.

**States’ Rights.** The sovereign right of a state to levy, assess, and collect tax existed before our current U.S. Constitution, including the Commerce Clause, was ratified. The Tenth Amendment to the U.S. Constitution expressly protects these states’ rights. A reasonable expansion of Congress’ Commerce Clause authority has been applied to limit state sales and use tax collection authority to the extent, under applicable precedent, the tax collection obligation is an undue burden on interstate commerce. The alternative approach presented in the prior discussion respects a state’s sovereign right to levy and assess sales and use tax and allows for collection from a remote seller (with a change in the nexus standard) in a manner that complies with state law or, to the extent that such compliance is an undue burden on interstate commerce, a less burdensome approach for compliance and collection under a federal program (to be developed; generally consistent with SSUTA compliance and administrative procedures).

**Privacy Rights.** Looking forward, privacy, information, and financial transaction security (including reporting of information and payment of tax to state agencies) will continue to require significant attention both within a state and in interstate commerce. Without taking anything away from the states (in the alternative arrangement presented), a federal clearinghouse (specifically, a longer term electronic compliance and tax collection portal) could provide significant additional protection in this area by centralizing the process and leveraging best-in-class technology and national security protocols in a single point-of-access solution as compared to the state-by-state approach for sales and use tax compliance reporting and collection today.

**Conclusion**

Remote seller state sales and use tax collection and compliance is a significant and increasing economic issue for state and local jurisdictions. States are not currently authorized to resolve this issue given the impact on interstate commerce and Congress’ Commerce Clause authority to regulate in that area. Federal legislative alternatives have been proposed, other options may be introduced, and this discussion includes several considerations and views supporting a uniform solution. The over-arching point is the compelling need from a state economic perspective for Congress to act quickly and move a legislative solution forward for enactment on this important issue.

In support of federal legislative action, three points previously discussed are summarized:

1. Respect sovereign state sales and use tax laws and differences; there are many and they reflect the policy choices of the people, business enterprises, and elected officials in each state.
2. Establish a new Commerce Clause nexus standard—an economic nexus standard is suggested.
3. Create a remote seller sales and use tax collection program to reduce interstate sales and use tax compliance burdens and increase state sales and use tax collections (this will take bold action, leadership, consensus, and investments; the return on those investments should be billions of dollars in annual state tax collections that will otherwise be permanently lost). This should be something that all parties agree is essential to the continued existence and fiscal health of the states. **This could be the legacy of the 114th United States Congress.**