

STATEMENT SUBMITTED FOR THE RECORD TO

**THE UNITED STATES SENATE
COMMITTEE ON FINANCE**

FULL COMMITTEE HEARING

**TAX REFORM AND WHAT IT MEANS FOR
STATE AND LOCAL TAX AND FISCAL POLICY**

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STATEMENT SUBMITTED BY

R. DAVID L. CAMPBELLⁱ
CHIEF EXECUTIVE OFFICER

AND

JOAN WAGNONⁱⁱ
EXECUTIVE VICE PRESIDENT

THE FEDERAL TAX AUTHORITY, LLC
162 EAST AVENUE
NORWALK, CT. 06851-5715

Alexander Hamilton wrote in *The Federalist* in 1788 that “individual States should possess an independent and uncontrollable authority to raise their own revenues for the support of their own wants.”

Today the discussion about state sovereignty over matters of taxation continues unabated. State revenue directors have seen firsthand how the actions of the federal government have affected state and local revenues. Members of Congress are increasingly bombarded by requests for action because state laws are restrictive to business or seen as unfair. There are any numbers of examples where congressional action has been beneficial or harmful to states.

But the issue that has been most devastating to state and local government has resulted from Congressional inaction, rather than action: the failure of Congress to overturn *Quill v North Dakota*.ⁱⁱⁱ

The Marketplace Fairness Act (MFA), S. 1832, sponsored by a bipartisan group of senators (Enzi, Durbin, Alexander, et. al.) is a good solution to the revenue problems of states, but more importantly, it gives states a better mechanism than they have now to collect the taxes they already levy.^{iv}

The MFA also corrects a growing imbalance between groups of retailers. Under the current court ruling, tax is collected on some sales and not on other sales of the exact same items. Why should tax be collected on a book or camera purchased from a local business and not on an identical item purchased from a mail order or internet business?

Remote sales are growing at double digit rates.^v However, states’ inability to collect sales tax on these sales results in the erosion of the states’ tax bases. Certainly this unfairness is not the hallmark of good tax policy! Congress is creating winners and losers among the retail community by its inaction.

Opponents cite two specific reasons for allowing this unfair situation to continue: a) that remote collection would be overly burdensome and complex, and b) that any systems necessary for remote collection would be prohibitively costly. This testimony will provide technical information for Congress to consider when evaluating those arguments.

I. THE COMPLEXITY ARGUMENT

Technology has advanced considerably since the 1967 and 1992 Supreme Court rulings that created the current sales tax situation. Even the more recent of these, *Quill*, occurred before the first graphical browser was invented, before most homes had internet connections, and long before e-commerce forever changed the retail landscape. Today, forty-five years after *Bellas Hess* and twenty years after *Quill*, online marketplaces and auction sites easily manage millions of items for sale at any given moment.

Today, keeping track of a few thousand local tax rates and filing requirements is not an insurmountable technical, administrative, or financial burden. TaxCloud, the sales tax management system created by FedTax, proves this point by calculating and collecting sales tax on any purchase for any tax jurisdiction in the United States *in less than one second*. The service is free to all retailers.

The technologies necessary to create such a system are not new; they are well-established. In fact, they are currently being used throughout e-commerce. They are Application Programming Interfaces and Web Services. An Application Programming Interface (API) allows dissimilar and unrelated systems to communicate with each other using pre-established syntax and structure. Web Services allow APIs to be used for machine-to-machine interactions over the internet. Both are now commonly used in e-commerce—for example, in real-time-shipping, which allows a retailer to provide its customers with accurate, real-time quotes for shipping costs based on at least five variables, including weight, size, delivery speed, origin, and destination. Often customers can even compare shipping costs among multiple shippers.

With APIs, Web Services, and other technological advances of the past twenty years, it is now possible for remote retailers to easily keep track of every state's tax laws.

To minimize or completely eliminate the undue burdens cited in *Bellas Hess* and *Quill*, more than half of the states with sales tax have worked together for twelve years to create the Streamlined Sales and Use Tax Agreement (SSUTA). These states provide free rates and boundaries databases for all of their respective taxing jurisdictions, and regularly issue updates when rules, rates, or boundaries change. In addition these states also certify and pay for software and service providers to manage sales tax compliance on behalf of retailers.^{vi} The Marketplace Fairness Act requires that any states seeking remote collection authority shall comply with SSUTA or provide comparable rates and boundaries information as well as certified software and services that retailers can rely upon to achieve compliance with minimal burden.^{vii}

Ironically, those who argue most strenuously that remote collection would be too complex are a few large online businesses that already rely on these same technologies every day, in every transaction. The plain fact is that online retailers operate the largest marketplaces in the world by relying on technology to simplify and automate a host of historically burdensome chores, including payment automation, location-specific marketing, personalized recommendations, and even Duties and Value Added Tax management for foreign governments.

II. THE COSTS-OF-COMPLIANCE OR UNDUE BURDEN ARGUMENT

Opponents also argue that even if technology can solve the technical burden of keeping track of rates, jurisdictions, and filing complexities, such software would be prohibitively costly, particularly for small businesses. TaxCloud is provided to retailers at no cost—so the argument that such

software would be prohibitively costly should be flatly disregarded. However, the costs-of-compliance argument also maintains that even if the software is free, businesses will still be burdened with the cost of integrating such software into their existing systems.

This line of argument ignores the reality that all but the very largest retailers rely upon pre-written software and/or online hosted platforms for e-commerce and order management. Retailers rely upon these systems to avoid the costs of developing, managing, and maintaining such systems on their own, costs that are magnified by the changing nature of e-commerce. It is no secret that e-commerce is constantly changing to respond to evolving cyber-crime threats, payments and security industry best-practices, and, yes, legislative requirements. When their retailer clients need to collect sales tax, platform vendors will provide ways for them to do so, embedded within the platforms that retailers already use.

E-commerce platform vendors are intensely competitive and focused; they take pride in not only complying with evolving requirements but often surpassing them, occasionally with stunning results. For example, much of the cloud computing infrastructure now transforming every corner of the technology sector can be traced to several of the largest e-commerce companies adapting to comply with the Sarbanes Oxley Act of 2002. Most platforms already provide basic sales tax management features for their clients. Upon enactment of MFA, these existing systems will quickly be adapted to ensure compliance.

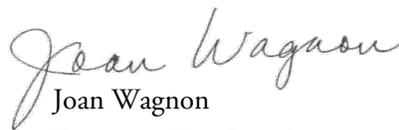
To conclude, modern technology has made it easy for retailers to collect sales tax for any state in the U.S. TaxCloud enables retailers of any size to easily collect sales tax and comply with the provisions of The Marketplace Fairness Act—for free. More information is available at TaxCloud.net.

And in addition to TaxCloud, five other companies are certified by the Streamlined Sales Tax Governing Board and ready to assist when Congress authorizes collection—and no doubt hundreds more will emerge soon after legislation is passed, because the free-market system will provide the incentive for entrepreneurs and innovators to develop these products.

Please don't wait to enact the Marketplace Fairness Act until all the parts of tax reform are in place. Passing this one bill can be the foundation for future reform as well as provide great benefit to both state and local governments. It also benefits brick and mortar retailers. Creating the same tax collection system for retailers whether they sell online or in a store is only fair.



R. David L. Campbell
Chief Executive Officer



Joan Wagnon
Executive Vice President

Endnotes

ⁱ David Campbell, Chief Executive Officer of The Federal Tax Authority (FedTax), founded the company in 2008. FedTax is a Washington State Limited Liability Company with operations in Washington, Connecticut, and Kansas. Its management team includes highly experienced professionals who have been directly involved in building some of the most recognizable brands in e-commerce, including MasterCard, Google, WebMD, Microsoft, Expedia, and American Express.

ⁱⁱ Joan Wagnon served as Secretary of Revenue in Kansas from 2003 to 2011. She also chaired the Streamlined Sales Tax Governing Board in 2008-9 and the Multistate Tax Commission from 2006 to 2008. She served on the Board of Directors of the Federation of Tax Administrators for 8 years before joining FedTax to work toward the passage of federal legislation granting states' collection authority over remote sales.

ⁱⁱⁱ The notion that out-of-state retailers would find it overly burdensome to keep track of every state's sales tax rules can be traced directly to the 1967 Supreme Court ruling in *National Bellas Hess v. Illinois Department of Revenue*. In its majority opinion, the court ruled that “the **many variations in rates** of tax, in allowable **exemptions**, and in administrative and **record-keeping requirements** could entangle National's interstate business in a virtual welter of complicated obligations to local jurisdictions” (emphasis added).

In 1992, the matter of remote sales tax collection came before the Supreme Court again in *Quill v. North Dakota*. This time, the court reaffirmed the earlier *Bellas Hess* decision by a ruling of 8 to 1, primarily on the basis of *stare decisis*. The ruling went on to state, “[O]ur decision is made easier by the fact that 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.”

FedTax frequently cites the earlier *Bellas Hess* quote because it summarizes the ruling's basis in complexity and burden, which has rippled forward to the present day and created a tidal wave of unintended consequences. This ruling has shielded all out-of-state retailers from the obligation to collect sales tax, based purely on the notion that it would place too much of a burden on businesses. Perhaps it would have, in 1967. That was the year the floppy disk was invented at IBM.

^{iv} States typically depend on voluntary means of collecting from individuals, such as a voluntary line on the income tax form. Audit procedures, which are used for businesses, are ineffective for consumers.

^v On Cyber Monday (the first Monday after Thanksgiving) in 2011, over \$1.2 billion in sales were transacted online. On that day alone, approximately \$58 million in sales tax went uncollected.

^{vi} FedTax has been designated a Certified Service Provider (CSP) by the Streamlined Sales Tax Governing Board specifically for its TaxCloud service. There are six CSPs and 24 member and associate member states.

^{vii} Although “software and services” is not defined in the Marketplace Fairness Act, likely it will include Application Programming Interfaces (APIs), Web Services, rates and boundaries databases, and a process for certifying service providers to process returns accurately under state laws.