

THE STREAMLINED SALES AND USE TAX AGREEMENT: HOW ENTREPRENEURS CAN PLAN FOR THE UNCERTAIN FUTURE OF E-COMMERCE SALES TAXATION

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I. INTRODUCTION

Confusion. Uncertainty. Miscommunication. Wasted expenses to upgrade accounting systems. Hours of compliance work. These are the results of going after the vast untapped reserves of sales tax revenues on electronic sales. Washington has just become the twenty-second state to join the Streamlined Sales Tax Project.¹ Businesses there can look forward to these problems, as well as constant legislative changes, as the legislature tries to remain compliant with the uniform rules and definitions mandated by the Streamlined Sales and Use Tax Agreement. Although simplicity was the goal, it seems that “streamlining” is not so streamlined.

For an entrepreneur, anticipating and accommodating these constant changes can be daunting. As the states making these changes purport to simplify the collection of sales taxes nationwide, businesses are struggling to keep up with the changing rules that are anything but simple. The prevalence of internet sales and businesses delivering all over the country now comes with the new burden of determining the tax rates for every customer’s location.² A project that began as a streamlining effort has become an albatross around the necks of businesses and the states, forcing them to make changes to remain in compliance with the new revenue-enhancing scheme.

This article will discuss the purpose and work of the Streamlined Sales and Use Tax Agreement and its members to date in working towards a national sales tax system that overcomes the obstacles noted by the U.S. Supreme Court. These obstacles have, until now, prevented states from forcing businesses to collect sales taxes on internet and mail order sales. Section II will provide a general overview of the Project, including its origins and activities to date. Born out of a call to arms from the U.S. Supreme Court, the states have come together in an unprecedented movement to overcome

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¹ Courtney Sherwood, *New Sales Tax is Trouble, in a Nutshell*, COLUMBIAN (Spokane, WA), July 22, 2008, at E1.

² For example, the state of Ohio has 96 taxing jurisdictions and a total of six different rates. OHIO DEP’T OF TAXATION, 2007 ANNUAL REPORT 125-126 (2007).

obstacles to their universal collection of sales and use taxes. While the intentions of those involved in the Project may have been good, the constant law changes and uncertainty that now plague the world of sales taxation have created an environment that is all but impossible for businesses to keep up with.

One of the biggest problems facing businesses—a change in how some businesses must now source their sales for sales tax purposes, along with others—will be discussed in Section III. Recently, a new option for Project-member states has become available, allowing some businesses to avoid the sourcing problem entirely. While some see this new development as the saving grace of the Project, others see it as yet another example of the Project being unable to hold itself to its strict standards for uniformity and administrative ease. It is uncertain at this time which viewpoint is correct.

Swift congressional action can solve the problems that have accompanied the Project by making the Project's requirements applicable nationwide, thereby overturning the U.S. Supreme Court's decision that sales taxes cannot be forcibly collected from all businesses for every state. Section IV will address the past, present, and future of the Project's proposals to and lobbying of Congress for federal legislation. Self-interest, governance problems, and changing jurisprudence on nexus standards have increased the uncertainty about the future of capturing sales taxes on e-commerce. While federal action has been absent up to this point, Congress needs to step up and take reign of a project that has bitten off more than it can chew. Given the current economic climate, action is becoming more and more likely.

II. THE STREAMLINED SALES TAX PROJECT: AN OVERVIEW

The Streamlined Sales Tax Project (SSTP or The Project) arose from the wasteland left after the U.S. Supreme Court ruled that states could not force vendors without sufficient nexus to collect sales taxes.³ With states losing more than an estimated \$15.1 billion per year⁴, a group of states, under the auspices of the National Conference of State Legislatures, came together in

³ *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). See further discussion in section II (A) below.

⁴ *The Sales Tax Fairness and Simplification Act: Hearing on H.R. 3396 Before the Subcomm. on Admin. and Commercial Law of the H. Comm. on the Judiciary*, 110th Cong. 4 (2007) (statement of Steven Rauschenberger, Past President, National Conference of State Legislatures) (“According to the Center for Business and Economic Research at the University of Tennessee, in 2003, the estimated combined state and local revenue loss due to remote sales was between \$15.5 billion and \$16.1 billion. For electronic commerce sales alone, the estimated revenue loss was between \$8.2 billion and \$8.5 billion...[B]y 2003, the revenue loss...could be as high as \$33.6 billion, of which it is estimated that \$17.8 billion would be from sales over the Internet.”)

an attempt to overcome the obstacles noted by the Court and to simplify the sales tax systems.

Today, 22 states are members of the Project⁵, and more than 1,100 vendors are voluntarily collecting sales taxes on their delivery sales in member states⁶. In a world where an increasing percentage of sales are made online⁷, and states' coffers are running dry⁸, the Project is becoming increasingly important. As of April 2008, an estimated \$170 million in revenue has been remitted that would have previously gone uncollected.⁹ Although legislative proposals have been repeatedly introduced in Congress to make the necessary law changes to require vendors to collect sales taxes nationwide, no action has yet been taken.¹⁰

A. The Supreme Court Shuts Down Taxing E-Commerce

The SSTP was born of necessity. Although states impose a legal duty on brick-and-mortar sellers¹¹ within their borders to collect sales taxes, the Supreme Court has ruled that a state cannot impose the same duty on remote sellers (i.e., catalogue and Internet retailers) who lack sufficient nexus

⁵ <http://www.streamlinedsalestax.org/govbrdstates.htm> (last visited Apr. 7, 2009). Members of the project are divided into two groups: "full member states," which are considered in full compliance with the SSUTA's provisions, and "associate member states," which are expected to be fully compliant by July 1, 2009. Currently, Ohio, Tennessee, and Utah are the only associate member states.

⁶ Rauschenberger testimony, *supra* note 4, at 10.

⁷ The U.S. Census Bureau reported that from 2001 to 2006, retail "e-sales" increased at an average annual rate of 25.4%, compared with 4.8% for total retail sales. Total U.S. retail e-commerce sales totaled almost \$107 billion in 2006. U.S. CENSUS BUREAU, 2006 E-COMMERCE MULTI-SECTOR REPORT 3-4 (2008).

⁸ Press Release, National Conference of State Legislatures, What a Difference a Year Makes: More States are Facing Budget Woes (July 23, 2008) (<http://www.ncsl.org/programs/press/pr0708StateBudgetfinal.htm> (last visited Apr. 7, 2009)).

⁹ Michelle Blackston, *Closing the Online Tax Loophole*, 34 STATE LEGISLATURES 4, Apr. 1, 2008, at 24.

¹⁰ Internet and Tax Moratorium and Equity Act, S. 512, 107th Cong. (1st Sess. 2001) (left pending in the S. Comm. on Finance); Streamlined Sales and Use Tax Act, S. 1736, 108th Cong. (1st Sess. 2003) (left pending in the S. Comm. on Finance); Streamlined Sales Tax Simplification Act, S. 2153, 109th Cong. (1st Sess. 2005) (left pending in the S. Comm. on Finance); Sales Tax Fairness and Simplification Act, H.R. 3396, 110th Cong. (1st Sess. 2007) (currently pending before the Subcom. on Administrative and Commercial Law of the H. Comm. on the Judiciary); Sales Tax Fairness and Simplification Act, S. 34, 110th Cong. (1st Sess. 2007); Sales Tax Fairness and Simplification Act, S. 35, 110th Cong. (1st Sess. 2007).

¹¹ "Brick-and-mortar" sellers are those with a physical presence in a state, such as a retail store.

(physical presence) in the state.¹² Overcoming this ruling by reducing the complexities of the mosaic of sales tax systems was the impetus for the Project.¹³

The internet sales tax problem is about nexus. With mail order companies challenging states' ability to tax them solely based on their activities within a state, the Supreme Court looked to the Due Process Clause and Commerce Clause to determine whether an out-of-state seller could be constitutionally taxed.¹⁴ The Court found that due process requires that a seller have "some definite link" with the state seeking to have a duty to collect sales taxes for the state, similar to what is required under personal jurisdiction jurisprudence.¹⁵ In the sales tax context, this requirement was refined by looking to the Commerce Clause's prohibition against any undue burden on interstate commerce, and the Court held that "at least some kind of *physical presence*"¹⁶ was required.¹⁷ The Court feared that imposing a sales tax collection duty on every interstate seller, forcing them to sift through the "many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements" was far too burdensome.¹⁸ If such a burden should ever be legally imposed, it must come from Congress.¹⁹

Attempts to impose a sales tax collection duty on out-of-state sellers was firmly forbidden in 1992 when the Court faced yet another out-of-state mail-order business' opposition to being forced to collect state sales taxes.²⁰ Just as in the *Nat'l Bellas Hess* case, the Court expressed concern for the burden created by the many variations in sales tax rates, exemptions, and

¹² Don H. Chamberlain, C. Tommy Stambaugh & Thomas I. Miller, *A Better System: The Streamlined Sales Tax Project*, 56 JOURNAL OF GOV'T FINANCIAL MGT. 3, Oct. 1, 2007 (citing *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992)).

¹³ Streamlined Sales and Use Tax Agreement (as amended Feb. 26, 2009), Art. I, § 102 (stating that the "fundamental purpose" of the agreement is to "simplify and modernize sales and use tax administration in the member states in order to substantially reduce the burden of tax compliance.") available at <http://www.streamlinedsalestax.org> (last visited Apr. 7, 2008).

¹⁴ *Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Illinois*, 386 U.S. 753 (1967).

¹⁵ Christina T. Le, *The Honeymoon's Over: States Crack Down on the Virtual World's Tax-Free Love Affair with E-Commerce*, 7 HOUS. BUS. & TAX L.J. 395, 403-404 (2007).

¹⁶ *Nat'l Bellas Hess*, 386 U.S. at 756-759.

¹⁷ The requirement of physical nexus is similar to the "minimum contacts" test for personal jurisdiction under the Due Process Clause, though it focuses on the burdens prohibited by the Commerce Clause, rather than on notice. Brian S. Masterson, *Collecting Sales and Use Tax on Electronic Commerce: E-Confusion of E-Collection*, 79 N.C. L. Rev. 203, 209-210 (2000).

¹⁸ *Id.* at 759-760. The Court also noted a House Report that noted the "clearly intolerable" recordkeeping task of multistate sellers that would be created if out-of-state sellers were forced to collect sales taxes.

¹⁹ *Id.* at 760.

²⁰ *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

administrative requirements.²¹ Again, a remote seller's delivery of goods into the state, without any form of physical presence, was held to be insufficient contact for purposes of establishing the requisite nexus under the Commerce Clause.²² The Court reiterated the concerns it noted in *Nat'l Bellas Hess*.²³ Again, the Court made clear that only Congress is qualified to destroy the bright-line rule created by the Court's decisions, and until that time, physical presence is required.²⁴

The result of these decisions was an imbalanced tax system—states are now forced to tax their own businesses more heavily than out-of-state sellers.²⁵ The Supreme Court's decisions have created an incentive for consumers to purchase from out-of-state sellers without nexus in their state to avoid paying state sales taxes.²⁶ As the mail-order business has given way to the more popular and easier world of e-commerce,²⁷ the decisions' impact has become even more troublesome. However, the concerns expressed by the Court provided a blueprint for states to follow in simplifying the tax systems that “unduly burden interstate commerce” and meet the constitutional requirements of the Commerce Clause.²⁸ If the variations in tax rates, exemptions, and administrative requirements that concerned the Court were eliminated, perhaps the burden on out-of-state sellers would no longer bar states from collecting what they feel is their due.

²¹ *Id.* at 313. The Court noted that a business would have to comply with 6,000-plus taxing jurisdictions.

²² *Id.* at 311.

²³ *Id.* at 313.

²⁴ *Id.* at 318.

²⁵ Brian Galle, *Designing Interstate Institutions: The Example of the Streamlined Sales and Use Tax Agreement*, 40 U.C. DAVIS L. REV. 1381, 1392 (2007). For example, an internet-based company with a physical presence in State A would be forced to collect sales taxes on sales to residents of State A, while sales to residents of State B would be tax free.

²⁶ Although consumers are legally liable for the state sales tax charge on these purchases through the state's use tax, it is rarely enforced. *Le, supra* note 15, at 400.

²⁷ U.S. CENSUS BUREAU, *supra* note 7.

²⁸ *Quill*, 504 U.S. at 313. A 2003 joint public-private study estimated that, because of the complexity and differences among states' rules, it cost retailers \$6.8 billion to collect and remit state and local sales taxes. Blackstone, *supra*.

B. *The States Listen: The Project is Created*²⁹

The SSTP began as a special task force of the National Conference of State Legislatures' Executive Committee.³⁰ The Task Force established a set of principles³¹ upon which the model legislation for the SSTP was based. Beginning in 2000, state officials³² began to work with representatives of the retail industry to develop "a simpler, uniform and fairer system of sales and use taxation,"³³ in response to the Court's finding that the current system is unduly burdensome.³⁴ Their efforts led to creation of the Streamlined Sales and Use Tax Agreement (SSUTA) in November 2002.³⁵

The SSUTA is an interstate compact among voluntarily participating states. Uniform definitions, limits on the number of tax rates, and uniform administrative procedures are among the provisions of the Agreement, which is designed as model legislation for those states that participate in the Project.³⁶ States become "members" of the agreement once their state tax laws have achieved "substantial compliance" with the provisions of the Agreement.³⁷ The Agreement became effective for its members on October 3, 2005,³⁸ when the required threshold of twenty percent of the total population of those states imposing a state sales tax was reached.³⁹

²⁹ For a more comprehensive overview of the origins of the Project, see Joseph R. Feehan, *Surfing Around the Sales Tax Byte: The Internet Tax Freedom Act, Sales Tax Jurisdiction and the Role of Congress*, 12 ALB. L.J. SCI. & TECH. 619 (2002), and WALTER HELLERSTEIN & JOHN A. SWAIN, STREAMLINED SALES AND USE TAX (Warren, Gorham & Lamont of RIA 2006/2007) (2004).

³⁰ "Task Force History," available at <http://www.ncsl.org/programs/fiscal/history.htm> (last visited Apr. 7, 2009).

³¹ These principles include, among others: (1) treating transactions in a competitively neutral manner, (3) not giving Internet vendors preferential tax treatment at the expense of local merchants, (4) the need for significant simplification of state and local sales and uses taxes to reduce the administrative burden of collection, (5) requiring remote sellers to collect taxes without regard to physical presence in the state, and (7) opposition to any federal action to preempt the right of states to determine their own tax policies.

³² Those working on the Project include state tax administrators and state legislators. *Galle*, *supra* note 25, at 1412.

³³ Rauschenberger testimony, *supra* note 4, at 8.

³⁴ *Quill*, 504 U.S. at 313 n.6 (noting the complexity of North Dakota's use tax as an example of the undue burden placed on interstate commerce).

³⁵ Blackstone, *supra* note 9.

³⁶ *Galle*, *supra* note 25, at 1393.

³⁷ *Id.* at 1394.

³⁸ Press Release, Streamlined Sales Tax Project, Sales Tax Simplification Agreement Becomes Effective Today and Launches Key Element: Amnesty Program (Oct. 3, 2005), available at <http://www.streamlinedsalestax.org> (last visited Apr. 7, 2009).

³⁹ SSUTA §701 (as amended Sept. 5, 2008) available at <http://www.streamlinedsalestax.org> ("The Agreement shall become binding and take effect when at least ten states comprising at least twenty percent of the total

1. *State Participation*

Today, 22 states are participating in the project.⁴⁰ Of those, only 19 are “full member” states in full compliance with the model provisions of the Agreement.⁴¹ Although not a part of the original Project’s plan, “associate” membership status has been created to allow states that have enacted compliance legislation, but which has not yet gone into effect, to stay involved with the Project and receive its benefits. This status was largely enacted in response to the difficulty in many states of rapidly making the changes required by the Agreement, some of which required great deviations from traditional practices, and in fear of losing the requisite twenty percent national population threshold.⁴² Given recent changes in the Agreement, discussed further in Section III, several new states are actively considering joining.⁴³ As more states come into compliance with the Agreement’s provisions, the Project’s goal of overcoming the “undue burden” cited in *Quill* is coming closer to being realized, and the Project’s pleas to Congress to enact federal legislation are becoming more pronounced.

2. *Seller Participation*

Under *Quill*, even if the states come together and simplify their sales tax systems, no seller lacking sufficient nexus with a state can be constitutionally required to collect that state’s sales taxes.⁴⁴ Therefore, voluntary seller participation in the Project is critical to its effectiveness. In return for their participation by collecting states’ sales taxes, the Project offers amnesty for past uncollected taxes to voluntary participants who register within twelve months of a state’s effective date of participation in the

population...of all states imposing a sales tax as of October 1, 2005 have petitioned for membership and have either been found to be in compliance...or have been found to be an associate member pursuant to Section 704.”).

⁴⁰ The current members of the SSTP are Arkansas, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, Nevada, New Jersey, North Carolina, North Dakota, Oklahoma, Rhode Island, South Dakota, Vermont, Washington, West Virginia, and Wyoming. Ohio, Tennessee, and Utah are “associate members” of the Project. www.streamlinedsalestax.org (last visited Apr. 7, 2009).

⁴¹ <http://www.streamlinedsalestax.org/govbrdstates.htm> (last visited Apr. 7, 2009).

⁴² Billy Hamilton, *A Small Miracle—The Streamlined Governing Board Compromises on Sourcing*, 47 STATE TAX NOTES MAGAZINE 53 (Jan. 7, 2008).

⁴³ E.g. Casey Ross, *Patrick Wants Net Sales Tax Created: Mass. Coffers Would Gain \$15m Per Year*, BOSTON GLOBE (Jan. 6, 2009), at 5 (Massachusetts considering joining); *Shopping as Civic Duty*, WICHITA EAGLE (Nov. 24, 2007), at A2 (noting that Texas and Florida are among 10 states considering joining).

⁴⁴ *Quill*, 504 U.S. 298 (1992).

Project.⁴⁵ As of November 2007, more than 1,000 companies had registered to voluntarily collect⁴⁶ and had remitted more than \$83 million of otherwise uncollectable sales tax revenue for participating states.⁴⁷ For larger businesses that are able to easily track the tax rate for each delivered sale, the Project's uniformity goals and amnesty benefits are extremely appealing. Smaller businesses, however, may still find that the compliance work needed is too cumbersome and outweighs any potential benefits.

C. *The States Go to Congress*

Despite the enormous accomplishments of the Project in making state tax systems uniform, the states cannot change the current prohibition on taxing remote sales by vendors without nexus on their own. Because the *Quill* Court held that the dormant Commerce Clause prohibited states from imposing the undue burden of complying with so many different taxing jurisdictions' rules on remote sellers, Congress must take affirmative action under their Commerce Clause powers to overturn the decision. This is the biggest, and possibly insurmountable, hurdle that the Project must overcome.⁴⁸

The stakes involved in this hurdle, however, are high. As economic conditions continue to worsen, states need every bit of tax revenue they can get. Ohio estimates that it is losing \$350 million to \$400 million a year in sales tax revenue from businesses without operations in the state,⁴⁹ just as it is facing a \$7.3 billion budget deficit.⁵⁰ Washington estimates it is losing twice that much.⁵¹ And the volume of sales occurring online is increasing.⁵² The

⁴⁵ SSUTA § 402(A)(1). This benefit is accomplished by requiring each member state to provide amnesty to sellers—"A member state shall provide amnesty for uncollected or unpaid sales or use tax to a seller who registers to...collect...in accordance with the terms of the Agreement." SSUTA § 402(A)(1) available at <http://www.streamlinedsalestax.org> (last visited Apr. 7, 2009).

⁴⁶ *Sales Tax Fairness and Simplification Act: Hearing Before the Subcomm. on Commercial and Admin. Law of the H. Comm. on the Judiciary*, 110th Cong. (Dec. 6, 2007) (statement of Joan Wagnon, President, Streamlined Sales Tax Governing Board).

⁴⁷ Chamberlain et al., *supra* note 12.

⁴⁸ See Billy Hamilton, *Internet Sales Tax: What if There's No There There?*, 49 STATE TAX NOTES MAGAZINE 627 (Sept. 1, 2008) (discussing the reasons why Congress has no incentive to act on legislation to allow state sales taxation of remote sales).

⁴⁹ Matt Burns, *Ohio Opt's Out of the Internet Sales Tax Group*, BUSINESS FIRST (COLUMBUS), Oct. 2, 2007 (statement of Ohio Tax Commissioner Richard A. Levin).

⁵⁰ Jeff Bell, *Strickland Address Speaks to Ohio Cuts, Tax Credits, Education Reform*, BUSINESS FIRST (COLUMBUS), Jan. 28, 2009.

⁵¹ Richard Ripley, *New Sales-Tax Collection System will Challenge Retailers*, 22 JOURNAL OF BUSINESS (SPOKANE, WA), Sept. 13, 2007, at B11 (statement of Mike Gowrylow, spokesman for the Washington State Department of Revenue).

⁵² Online purchases on "Cyber Monday" in 2007 (the Monday following Thanksgiving) increased 21% over spending on the same day in 2006, while total

states have a huge incentive to prove to Congress that their uniformity and simplification goals are making sales taxation more bearable for online sellers.

After several years of introducing legislation without success, the Project is apparently ready to face the congressional hurdle head on. As of April 7, 2009, the Project is seeking a “highly qualified and experienced governmental affair expert(s) to assist the Board with its federal governmental affairs objectives.”⁵³ Congress likely has little motivation or desire to apply state sales taxes to the tax-free world of e-commerce. The Project’s leaders will need to demonstrate the dire need for more state revenue in light of the current economic climate, the willingness of states to make sacrifices to get at this new revenue, and the need to conform tax policy to the realities of today’s world.

III. THE BIG PROBLEM FOR BUSINESSES: DESTINATION-BASED SOURCING

For many businesses, unifying and simplifying states’ tax rules are highly beneficial. However, those businesses that are accustomed to only needing to know the tax rate of their physical location may view the Project and its goals as just the opposite. Conversion to a new sourcing system has proven to be a very burdensome task. The new focus of the Project has become easing states’ and businesses’ burdens. Unless this problem is solved, the fate of the Project looks more likely to be dissolution than triumph. However, solving the problem has led to deviations from the Project’s goals. Such deviations may be more likely to cause dissolution than the problem itself.

A. *What is Destination-Based Sourcing and Why is it a Problem?*

Heeding the warning of the U.S. Supreme Court that the varying and inconsistent obligations make sales tax collection too burdensome,⁵⁴ the Project established uniform rules. One of these was destination-based sourcing.⁵⁵ Before the Project, under state law, some states charged sales tax

spending increased only 17%. Hamilton, *supra* note 42 (citing report on holiday e-commerce spending by comScore, an Internet monitoring firm).

⁵³ RFP #2008-02, Streamlined Sales Tax Project, <http://www.streamlinedsalestax.org/DOCUMENTS/RFPs/RFP%202008-002%20Gov%20Affairs%20Services.pdf> (last visited Apr. 7, 2009).

⁵⁴ See *Quill*, 504 U.S. at 313 n. 6.

⁵⁵ SSUTA § 310 (as amended Sept. 5, 2008) available at <http://www.streamlinedsalestax.org>. For a detailed description of the Agreement’s sourcing rules, see Walter Hellerstein & John A. Swain, *The Streamlined Sales and*

rates based on where a consumer purchased a product or service; this is “origin-based sourcing.”⁵⁶ Other states based the sales tax rate on where the product ends up—“destination-based sourcing.”⁵⁷ This is not a problem for regular retail in-store purchases; however, purchases that are to be delivered to a different taxing jurisdiction must be taxed at the tax rate in the location where they ultimately end up (the delivery location). In states without multiple taxing jurisdictions, destination-based sourcing is not a problem. For states like Ohio, Tennessee, Kansas, Washington, and others with multiple local taxing jurisdictions, destination-based sourcing forces businesses to track delivery sales and the tax rates of each jurisdiction and shifts millions of dollars in sales tax revenue among the state’s taxing jurisdictions.⁵⁸

In the world of origin-based sourcing, knowing what sales tax rate to charge in a state with multiple jurisdictions is easy—the vendor only has to know the rate in the county where he is located. Under destination-based sourcing, however, a vendor making delivery sales⁵⁹ must know the tax rate in every location in which his purchasers are accepting products. For some businesses, especially larger businesses that do large volumes of delivery sales, collecting sales taxes on a destination basis is thus “horrendously

Use Tax Agreement’s Sourcing Rules, 34 STATE TAX NOTES MAGAZINE 375 (Nov. 8, 2004).

⁵⁶ For example, if someone walks into a retail store in county X in the state of Y, buys something, and then takes the product to county Z, the consumer is charged the sales tax rate of county X. This applies even if the consumer bought a product that is to be delivered to county Z at a later time. States that use origin-based sourcing are Kansas, Ohio, Tennessee, Texas, Utah, and Washington. States that use destination-based sourcing are Kansas, Ohio, Tennessee, Texas, Utah, and Washington. Gail Perry, *Sales Tax Program Slogs On*, 20 ACCOUNTING TODAY 1 (June 5, 2006).

⁵⁷ For example, if someone telephones a retail store in county X, and asks that a product be delivered to a location in county Z, the consumer is charged the sales tax rate of county Z. Therefore, the retail store must keep track of the rate in every county where it delivers products.

⁵⁸ For example, if county X had been receiving sales taxes collected under origin-based sourcing, all the businesses located there would be contributing sales taxes to the county coffers. Upon converting to a destination-based sourcing system, county X no longer collects sales taxes on sales its businesses make but deliver outside the county. For counties with large sectors of businesses doing delivery sales (particularly large items, such as furniture), this can result in drastic revenue reductions.

⁵⁹ Under the SSUTA, “delivery sales” are those sales when the product is not received by the purchaser at a business location of the seller, SSUTA § 310(A)(2) (as amended Sept. 5, 2008) available at <http://www.streamlinedsalestax.org> (last visited Apr. 7, 2009). Ohio defines “delivery sales” as “the taxable sale...that is received by a consumer...in a taxing jurisdiction that is not the taxing jurisdiction in which the vendor has a fixed place of business.” OHIO REV. CODE ANN. § 5379.033(B)(1)(a) (West 2008).

complicated.”⁶⁰ In addition, destination-based sourcing requires additional record keeping requirements to prove that the business collected the correct tax rate on a sale.⁶¹ Businesses with extensive accounting capabilities may be able to cope better with these changes by simply modifying their software, albeit at a cost. However, smaller businesses without sophisticated software⁶² or sufficient staff to handle these additional requirements now face an enormous compliance burden.⁶³

The requirement to convert to destination-based sourcing has kept many states from becoming involved with the Project. A recent amendment to the Agreement that permits origin-based sourcing on *intrastate* sales (discussed further below in Section B.5) has garnered great support from states such as Virginia, Texas, and Missouri, which are concerned with the problems the conversion will cause.⁶⁴ The absence of large states such as California, Florida, New York, and Texas, due to the destination-based sourcing requirement, significantly affects the Project’s leverage in Congress.⁶⁵ A problem of this magnitude must be addressed if *Quill* is to be overturned by congressional action.

⁶⁰ Andrea James, *Buying Online? State Sales Tax Now Awaits: Washington Law Kicks in Today*, SEATTLE POST-INTELLIGENCER, July 1, 2008, at E1 (comment of Amazon.com founder and CEO Jeff Bezos).

⁶¹ E.g. Ripley, *supra* note 51.

⁶² A distinct sector of business—Amish furniture makers—is particularly burdened. As mentioned by Ohio Rep. Bob Gibbs in his advocacy for a small business exemption or allowance of origin sourcing for intrastate sales, requiring these businesses, many of which don’t use electricity and thus don’t have technological solutions for tracing sales tax rates and collection, to convert is an enormous burden. Steven S. Woo, *Ohio Lawmaker Calls for Sourcing Amendment to Streamlined Agreement*, 34 STATE TAX NOTES MAGAZINE 358 (Nov. 8, 2004).

⁶³ To illustrate the problem, the total cost of complying with current law sales tax collection requirements is 3.09% of sales taxes collected for all retailers. For small retailers (annual sales of \$150,000 to \$1 million), this cost is 13.47%; for large retailers (annual sales over \$10 million) is only 2.17%. Chamberlain, *supra* note 12 at fn. 6 (citing Apr. 7, 2006, study of retail sales tax compliance costs by PricewaterhouseCoopers).

⁶⁴ Eric Parker, *Streamlined Governing Board Approves Origin-Based Sourcing Option*, 46 STATE TAX NOTES MAGAZINE 806 (Dec. 17, 2007) (citing comments from Virginia—“Origin is critical for the support of the Virginia Association of Counties;” from Missouri—“Without this proposal, we can’t even get this on the table”; and Texas).

⁶⁵ Hamilton, *supra* note 42.

B. *The Big Switch: Conversion from Origin to Destination-Based Sourcing*

Retailers in Washington are the most recent to tackle complying with a conversion to destination-based sourcing.⁶⁶ As seems to have been the case in other states, even extensive public education efforts have failed to alert all vendors of the change from origin to destination-based sourcing.⁶⁷ Possibly because of the context of the Project's origins and work in e-commerce, many businesses assume that the sourcing changes do not apply to brick-and-mortar stores.⁶⁸ Even more troubling are the consequences of the conversion that have led unsuspecting legislators to delay or even repeal legislation after the outcry from businesses forced to make the switch, causing even more confusion in the business community about the status of the law.

The costs of compliance have been extensive. Small retailers in Washington report spending \$1,000 to comply for changes affecting 1% of their business⁶⁹ and larger retailers with busy internet businesses report spending "tens of thousands of dollars" to upgrade software to track sales and tax rates throughout the state.⁷⁰ One study of compliance costs estimates that compliance costs for retailers with annual retail sales of \$150,000 to \$1 million are six times higher, as a percentage of sales or sales tax collected, than for retailers with annual sales of over \$10 million.⁷¹

For states with both multiple taxing jurisdictions and traditionally origin-based sourcing, the switch causes even more headaches for the distribution of tax revenues to counties, municipalities, and school districts.⁷² For example, as Ohio and Washington readied for the sourcing switch, they faced the political and practical problems that this shift in local revenue causes. The Washington Department of Revenue estimated that about \$32 million would be shifted.⁷³ The large concentration of Amish businesses in Holmes County, Ohio, was predicted to have huge consequences for the county's tax revenue, due to many furniture-making businesses no longer

⁶⁶ *Id.*

⁶⁷ James, *supra* note 60. See also Tom Sowa, *Shippers Face Sales Tax Hurdle: Law Changes How Charges Calculated*, THE SPOKESMAN-REVIEW (Spokane, WA), June 17, 2008, at 1A (noting that retailers in Washington were unprepared for the conversion to destination-based sourcing on July 1, 2008).

⁶⁸ Ripley, *supra* note 51.

⁶⁹ James, *supra* note 60.

⁷⁰ Ripley, *supra* note 51 (comments of Larry Eakins, CFO of Hupp's Hi-Fi, Photo & Video, Inc.).

⁷¹ PricewaterhouseCoopers, *Retail Sales Tax Compliance Costs: A National Estimate*, prepared for the Joint Cost of Collection Study, 8, available at: <http://www.streamlinedsalestax.org>.

⁷² See example above in note 58.

⁷³ Woo, *supra* note 62 (statement of Robert Nachlinger, finance director for the city of Kent, Washington).

contributing to the tax base after the switch.⁷⁴ States participating in the Project thus must cope with two newly found enemies – businesses and local governments.⁷⁵

C. Attempts at Solutions: Successful or Debilitating?

States wrestling with the problems that conversion to destination-based sourcing brings have made a number of attempts to lessen the burden. Both businesses and local governments have been brought in as advisors to the Project, with their own respective committees.⁷⁶ Perhaps most importantly, the Project itself has recognized the technological obstacles for many small businesses in accounting for sometimes thousands of tax rates and associated recordkeeping. Some states have developed their own, simpler systems for businesses that do not need the more sophisticated solutions that the Project has made available.⁷⁷ For those businesses that have had to make changes on their own, vendor compensation has been offered.

Instituting a phase-in period, to allow smaller businesses more time to make changes, has been offered as another solution, although this has kept some states from reaching full membership status right away.⁷⁸ With the failure of small business exemptions at the Project level and in Congress, a new origin-based sourcing option for intrastate sales may be the best solution offered to states and may turn a new leaf for the future of the Project.

⁷⁴ According to Ohio State Representative Bob Gibbs, Holmes County, Ohio, contains the highest concentration of Amish residents in the nation. *Id.*

⁷⁵ Although Utah has multiple taxing jurisdictions and traditionally origin sourcing, its revenue distribution plan pre-SSTP did not cause significant revenue shifting among local jurisdictions during the switch. *Id.* (statement of Utah State Tax Commissioner Bruce Johnson).

⁷⁶ Businesses are represented by the “Business Advisory Council” (BAC). SSUTA § 811. Local governments are represented by the “State and Local Advisory Council” (SLAC). SSUTA § 810 (as amended Sept. 5, 2008) *available at* <http://www.streamlinedsalestax.org> (last visited Apr. 7, 2009).

⁷⁷ It should also be noted that Ohio, particularly, faces the problem of coming up with solutions for the large segment of Amish doing business in Ohio. Because these businesses tend to do a large proportion of their business through delivery sales, they have a unique need for non-electronic solutions to help them track the multitude of Ohio tax rates. See e.g. Woo, *supra* note 62.

⁷⁸ In fact, these delays were the impetus for creating the “associate member” status that Ohio, Utah, and Tennessee are currently under. See also *Sales Tax Fairness and Simplification Act: Hearing Before the Subcomm. on Commercial and Admin. Law of the H. Comm. on the Judiciary*, 110th Cong. (Dec. 6, 2007) (statement of George S. Isaacson, Tax Counsel, Direct Marketing Association) (anticipating the adoption of the “associate member” status amendment by the SSTP to avoid Ohio leaving the project due to nonconformity with the SSUTA).

However, each of these attempted solutions brings problems of its own, and no solution seems to be the panacea that the Project needs to fully realize its goals.

1. *Technology solutions*

While tracking each state's tax rates and rules may have been overly burdensome in the days of *Quill* and *Nat'l Bellas Hess*, the modern availability of online solutions has the potential to ease that burden. The Project, along with the states themselves, has come up with technological solutions for businesses conducting commerce in multiple states. Given the advent of the internet as a gateway to seemingly limitless commerce, in the words of one commentator, the states have decided to fight fire with fire by using technology to aid in sales tax collection.⁷⁹

The Project has acknowledged the benefits that technology can bring to easing the transition to a more uniform national sales tax system and making participation in the Project more appealing for states and businesses alike. To that end, three technology models have been approved to allow sellers to turn over a certain portion of their sales tax functions to automated systems. Sellers can either use a "certified service provider" (CSP), "certified automated system" (CAS), or their own proprietary system, certified by the SSTP Governing Board. Using one of these certified systems⁸⁰ is a requirement to register as a seller through the agreement and receive the amnesty previously mentioned in Section II above.⁸¹

Use of a CSP is of particular aid to businesses, especially smaller retailers, who cannot afford to update or create their own sales tax tracking systems. Businesses can use a CSP to perform their sales tax functions at no cost.⁸² Each CSP that contracts with the SSTP Governing Board is paid through the new sales tax revenues that they collect.⁸³ Sales taxes are calculated using state-created databases and remitted using a simplified reporting form.⁸⁴ The two other technology models, a CAS or certified proprietary system, offer less assistance with collection but allow more control by the businesses using them. Each model is designed to meet the specific needs of different businesses.

⁷⁹ Arthur J. Cockfield, *Jurisdiction to Tax: A Law and Technology Perspective*, 38 GA. L. REV. 85, 99 (2003).

⁸⁰ The SSUTA defines each seller as either a Model 1, 2, or 3 seller based on which system they choose. Model 1 corresponds to those using a CSP (SSUTA § 205), Model 2 corresponds to those using a CAS (§ 206), and Model 3 corresponds to those with certified proprietary systems (§ 207).

⁸¹ SSUTA § 403.

⁸² Wagnon testimony, *supra* note 46.

⁸³ *Id.*

⁸⁴ *Id.* In addition, reliance on the state databases holds both the CSPs and retailers harmless from any liability for inaccurate remittance.

As one commentator has noted, easing the burden on sellers through uniformity and technological solutions offered to businesses are “giant steps forward.”⁸⁵ While the technological solutions unfortunately came too late for some businesses that were forced to convert to destination-based sourcing before any systems were certified,⁸⁶ they are certainly a vital aid to smaller retailers coping with the conversion.⁸⁷ Recognizing this, Ohio, for instance, delayed the effective date of its conversion for smaller retailers pending a determination that the technology solutions being offered were available and adequate to meet the needs of businesses.⁸⁸

2. Vendor Compensation

States have tried to alleviate the cost of complying with the sourcing change by providing direct compensation to vendors. The state of Washington has offered a \$1,000 tax credit for businesses grossing less than \$500,000 per year to cover the costs of compliance.⁸⁹ Ohio directly compensates vendors—twenty-five dollars per month for each county into which the business delivers for the first six months after the mandated conversion, up to the total cost of the business’s compliance.⁹⁰ Along with delaying its own implementation (discussed further in the Section IV), Kansas provided tax credits to small businesses to defray the costs of implementation.⁹¹

While this compensation certainly helps businesses who need to upgrade or convert computer systems, it has proven to be of only little value,

⁸⁵ Jere D. McGaffey, *Wisconsin Tax Policy Within a Federal System*, 88 MARQ. L. REV. 93, 99-100 (2004).

⁸⁶ The first three CSPs were not certified until June 1, 2006. Richard Thompson Ainsworth, *Biometrics: Solving the Regressivity of VATs and RSTs with “Smart Card” Technology*, 7 FLA. TAX REV. 651, 707 (2006).

⁸⁷ As a note, the problem for Ohio’s Amish business community remains. However, as detailed in Section III.C.5, a new option allowing businesses to use origin-based sourcing for intrastate sales will alleviate much of this burden.

⁸⁸ H.B. 294, 126th Gen. Assem., Reg. Sess. (Ohio 2007), included the following provision in Ohio Revised Code § 5739.033(B)(2): “On or before February 1, 2007, the tax commissioner shall determine whether certified service provider services are being provided by the governing board of the streamlined sales and use tax agreement for all delivery sales.” Conversion to destination-based sourcing was then made contingent on such a determination.

⁸⁹ Sherwood, *supra* note 1, at E1.

⁹⁰ OHIO REV. CODE ANN. § 5739.123 (West 2008). See also Information Release, Ohio Department of Taxation, ST 2005-01- Vendor Compensation (Apr. 2007) available at http://tax.ohio.gov/divisions/communications/information_releases/st200501.stm (last visited Nov. 14, 2008).

⁹¹ Ric Anderson, *Promptness May Not Pay Off: St. Marys Company in Limbo with New Tax System*, TOPEKA CAPITAL JOURNAL, Mar. 10, 2004, at C.

especially to small businesses without the market share to make the conversion more cost effective.⁹² As is the case elsewhere, mid-sized businesses in Washington have been left on their own to front the cost of upgrades and training.⁹³ Even as technological solutions are becoming more available and more affordable with state help, growing pains remain during the conversion process.

3. *The “Hurry Up and Wait” Approach*

Many states’ solutions to the outcries from the business community were moratoriums, phase-ins, and outright repeals. Kansas was the first traditionally origin-based state to convert to the new system in 2003,⁹⁴ and the first state to face the outcry from businesses that were forced to comply. Just months after the new sourcing law became effective, retailers began to call for its repeal.⁹⁵ Within weeks, state officials declared a six-month moratorium on enforcement,⁹⁶ and ultimately made the moratorium official until January 1, 2005.⁹⁷

After hearing complaints from the business community and having their pleas to the Project for a better solution go unheard, Ohio opted to exempt smaller businesses from the conversion for a period of time. Legislators decided to ease this pressure on businesses by “phasing in” the transition to destination-based sourcing.⁹⁸ Under the Ohio plan, as enacted in 2005, businesses were required to switch to destination-based sourcing at a certain time if they met a specific gross delivery sales threshold (the idea being that larger companies who are more able to cover the cost of compliance must switch over first).⁹⁹ Ultimately, once the conversion dates for those smaller

⁹² Parker, *supra* note 64, at 806 (citing concerns of Richard Prem, director of global indirect taxes for Amazon.com, that compensation to businesses is not sufficient).

⁹³ Ripley, *supra* note 51, at B11.

⁹⁴ Kansas’ conversion to destination-based sourcing became effective on July 1, 2003. Amy Bauer, “Noble Goal” Missed, TOPEKA CAPITAL JOURNAL, Aug. 16, 2003, at 11.

⁹⁵ *Id.*

⁹⁶ Scott Rothschild, *Kansas Officials Place Moratorium on Enforcing New State Sales Tax Law*, JOURNAL-WORLD (Lawrence, KS), July 16, 2003.

⁹⁷ Kenneth Daniel, *Legislature Boosts Small-Business Climate*, TOPEKA CAPITAL JOURNAL, May 23, 2004, at B. In addition, the Kansas legislature gave the state Department of Revenue the authority to forgive interest and penalties for noncompliance for an additional six months beyond the official moratorium.

⁹⁸ S.B. 26, 126th Gen. Assem., Reg. Sess. § 5739.033(B) (Ohio 2005).

⁹⁹ *Id.*; OHIO REV. CODE ANN. § 5739.033(B)(2) was amended to read:

(a) A vendor with total delivery sales in calendar year 2005 that are less than thirty million dollars may continue to situs its sales under section 5739.035 of the Revised Code from May 1, 2006, through April 30, 2007.

(b) A vendor with total delivery sales in calendar year 2006 that are less than five million dollars may continue to situs its sales under

thresholds were reached, compliance with destination-based sourcing was delayed and even put on a permanent hold.¹⁰⁰

Utah, one of the early leaders within the Project,¹⁰¹ followed Kansas and Ohio by delaying its conversion twice and ultimately eliminating destination-based sourcing in state law.¹⁰² With the flexibility allowed by a new amendment to the Agreement for sourcing intrastate sales (discussed further below), Utah now expects to be in full compliance by January 2009.¹⁰³

The problem with this “hurry up and wait” approach is that conscientious businesses have ultimately been punished for converting too soon. For example, businesses that voluntarily converted to destination-based sourcing as well as located on the border of a higher tax rate jurisdiction were placed at a competitive disadvantage. In addition, any company that made such a decision was hedging their bets against yet another law change; Ohio changed the dates of the transition several times¹⁰⁴ and eventually enacted a de minimis exemption for businesses with small amounts of delivery sales.¹⁰⁵ One Kansas retailer conscientiously paid for training and computer software to prepare for the conversion within weeks after the enactment of the new law. Furthermore, after the state enacted a moratorium on enforcement, retailers were left wondering whether their investments of thousands of dollars had gone to waste.¹⁰⁶ While state legislators were heeding the concerns of businesses, their actions led to even more confusion and frustration.

section 5739.035 of the Revised Code from May 1, 2007, through December 31, 2007.

(c) Beginning January 1, 2008, all vendors shall source their sales under divisions (C) to (I) of this section.

¹⁰⁰ See H.B. 119, 127th Gen. Assem., Reg. Sess. (Ohio 2007) (allowing those that had not yet converted to continue to use origin sourcing, allowing a one-time election to convert back to origin sourcing, and putting further mandatory conversion on hold until the SSTP Governing Board permits sellers with less than \$500,000 in annual intrastate delivery sales to continue to use origin-based sourcing). See also Burns, *supra* note 49.

¹⁰¹ Billy Hamilton, *Easy Rider—An Interview with Utah State Tax Commission Chair Pam Henrickson*, 49 STATE TAX NOTES 347, 347 (Aug. 4, 2008).

¹⁰² *Id.* After adopting destination-based sourcing in July 2004, the conversion was delayed in 2004 and 2005. In 2006, the Utah legislature returned to origin-based sourcing by enacting S.B. 233.

¹⁰³ *Id.*

¹⁰⁴ *E.g.*, S.B. 218, 125th Gen. Assem., Reg. Sess. (Ohio 2004); S.B. 26, 126th Gen. Assem., Reg. Sess. (Ohio 2005); H.B. 294, 126th Gen. Assem., Reg. Sess. (Ohio 2006); H.B. 119, 127th Gen. Assem., Reg. Sess. (Ohio 2007); H.B. 429, 127th Gen. Assem., Reg. Sess. (Ohio 2008).

¹⁰⁵ OHIO REV. CODE ANN. § 5739.033(B)(3) (West 2008) (providing that a vendor with total “delivery sales” of less than \$500,000 may use origin-based sourcing).

¹⁰⁶ Anderson, *supra* note 91, at C.

States are taking hold of the attractiveness of this approach, at least while Congress remains inactive. Legislation introduced this year in Arkansas would allow origin-based sourcing to continue until federal legislation is enacted.¹⁰⁷ It remains to be seen whether the trepidation of states to make painful changes in the name of the Project's ultimate goal will be a sign to Congress that the time for change has not yet come. Ultimately, though, the constant changes in conversion timelines and requirements are resulting in more confusion for businesses that are trying to remain in compliance.

4. Exemptions

As always seems to be the case with tax policy, the name of the game is exemptions. Because the conversion to destination-based sourcing is much more burdensome for smaller businesses and/or those only delivering intrastate, both federal and state legislation have proposed exempting those sellers below a certain threshold from the sourcing switch. While exemptions will not solve the overall problems that accompany conversion to destination-based sourcing, they do alleviate the pain on those who are least able to cope with the switch.

Small business exemptions have been part of multiple versions of federal legislation. Bills introduced in 2003 included an exemption for businesses with less than \$5 million in out-of-state sales.¹⁰⁸ In 2006, two versions of a small business exemption were introduced in Congress. One of these exempted all companies with revenue of less than \$5 million per year (S. 2152) and the other authorized the Small Business Administration to set the revenue limit (S. 2153).¹⁰⁹ Some states, such as Ohio, even proposed their own legislation to help those small businesses that sell only across local taxing jurisdiction lines, but not out of state.¹¹⁰

Perhaps because of recent developments on the sourcing issue discussed below, federal legislation expected to be introduced in 2009 will not include a small business exemption.¹¹¹ Instead, the exemption threshold would be set by the Governing Board, so that it can be modified accordingly as technology eases the collection burden.¹¹² Indeed, technology is simplifying collection, and recent action by the Governing Board on the sourcing front could eliminate the need for any small business exemption.

¹⁰⁷ H.B. 1179, 87th Gen. Assem., Reg. Sess. (Ark. 2009).

¹⁰⁸ Woo, *supra* note 62, at 358 (H.R. 3184, 108th Cong. (2003) & S. 1736, 108th Cong. (2003))

¹⁰⁹ Chamberlain et al., *supra* note 12.

¹¹⁰ Woo, *supra* note 62, at 358. Ohio State Rep. Gibbs' proposal, H.B. 407, 125th Gen. Assem., Reg. Sess. (Ohio 2004), would have exempted businesses with less than \$5 million in out-of-state sales from destination sourcing.

¹¹¹ *Small-Seller Exemptions in Remote Sales-Tax Bills Introduced*, WASHINGTON INTERNET DAILY, Nov. 14, 2008.

¹¹² *Id.*

5. *Good News on the Horizon: Origin-based Sourcing Option for Intrastate Sales*

Despite years of rigid adherence to its destination-based sourcing principle,¹¹³ the Project has finally recognized the problem that traditionally origin-based states have faced. On December 12, 2007, the Streamlined Sales Tax Governing Board amended the Agreement to allow origin-based sourcing for *intrastate* sales.¹¹⁴ Associate member states¹¹⁵ that choose this new option will be granted full membership status as of January 1, 2010 if an additional five states join the Project under the intrastate origin-based sourcing option.¹¹⁶ Convincing additional states to come on board under this new option should not be difficult. Several states have already commented that the prospect of converting to destination-based sourcing was the biggest obstacle to their involvement with the Project.¹¹⁷ And states that had contemplated leaving the Project are now more likely to remain involved.

Before the Agreement was amended to provide a solution for states struggling with the conversion to destination-based sourcing, the Project looked to be on its last legs. Several states even considered leaving the Project altogether. Utah and Ohio scaled back their plans to join as full members.¹¹⁸ As of October 2007, a trigger in Ohio law stopped the conversion to destination-based sourcing.¹¹⁹ The Project can now realistically court the

¹¹³ One commentary labeled this amendment a “miracle” due to the Board’s historic resistance to deviating from the destination-based sourcing requirement. Hamilton, *supra* note 42, at 53.

¹¹⁴ Parker, *supra* note 64, at 806. The new option can be found at SSUTA § 310.1 (as amended Sept. 5, 2008).

¹¹⁵ Currently Ohio, Tennessee, and Utah are associate member states. SST State Status Map. <http://www.streamlinedsalestax.org/govbrdstates.htm> (last visited Nov. 14, 2008).

¹¹⁶ SSUTA § 310.1(D)(2) (as amended Sept. 5, 2008) *available at* <http://www.streamlinedsalestax.org>.

¹¹⁷ *E.g.*, Parker, *supra* note 64, at 806 (comments of Virginia, Missouri, and Texas).

¹¹⁸ Hamilton, *supra* note 42, at 53.

¹¹⁹ OHIO REV. CODE ANN. § 5739.033(B)(2) (West 2008) (“If the tax commissioner does not make the certification under section 5740.10 of the Revised Code, a vendor that is not required...to [use destination sourcing] on the date of the commissioner’s certification may continue after that date to [use origin sourcing]...”);

OHIO REV. CODE ANN. § 5740.10(B) (West 2008):

If the tax commissioner determines, on or before October 1, 2007, that the [SSUTA] has been amended or interpreted by the streamlined sales tax governing board to allow, beginning January 1, 2008, a vendor with total annual delivery sales within this state of less than five hundred thousand dollars in a prior calendar year, beginning with calendar year 2007, to situs its sales under [origin sourcing].

participation of other states. This courtship is needed to reach a critical mass of states¹²⁰ capable of putting pressure on Congress to take action on overturning *Quill* through active use of their Commerce Clause powers.

IV. THE ULTIMATE GOAL—CONGRESSIONAL ACTION

As the *Quill* decision made clear, the only way to achieve the Project's ultimate goal—legally required collection of state sales and use taxes by sellers, regardless of their nexus with a state—is through federal legislative action.¹²¹ Although the participating states and SSTP Governing Board have been appealing to Congress to enact federal legislation overturning the *Quill* decision for several years, the Project now seems to be getting serious.¹²² However, recent deviations from the Project's principles and inherent flaws in its structure may make this latest push merely a last ditch effort before Congress puts its foot down on taxing e-commerce for the last time.

A. Legislative Efforts to Date

Congressional hostility toward taxation of e-commerce has been constant since 1998 when it enacted the Internet Tax Freedom Act, imposing a moratorium on e-commerce taxes.¹²³ Despite the efforts of the Project toward reducing the burden on sellers to collect states' sales taxes, Congress has extended the moratorium through 2014.¹²⁴ Legislation to overturn the *Quill* decision pursuant to the states' efforts towards uniformity was first introduced in 2003.¹²⁵ However, despite numerous subsequent introductions of legislation,¹²⁶ Congress has not yet taken action. As more states become

¹²⁰ See Hamilton, *supra* note 42, at 53 (mentioning that California, Florida, New York, and Texas, none of which are currently members of the Project and account for almost a third of the nation's population, may now be more inclined to participate).

¹²¹ *Quill*, 504 U.S. at 318 (“[T]he 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”; “Congress is now free to decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes”; “The precise allocation of such burdens is better resolved by Congress rather than this Court.”)

¹²² See RFP, *supra* note 53, at 7 (the SSTP Governing Board is advertising for a federal lobbyist).

¹²³ Internet Tax Freedom Act of 1998, H.R. 4328, 105th Cong. (2d Sess. 1998).

¹²⁴ Internet Tax Freedom Act Amendments Act of 2007, H.R. 3678, 110th Cong. (1st Sess. 2007) (enacted in 47 U.S.C. § 151 note).

¹²⁵ Streamlined Sales and Use Tax Act, H.R. 3184, 108th Cong. (1st Sess. 2003) & S.1736, 108th Cong. (1st Sess. 2003).

¹²⁶ Sales Tax Fairness and Simplification Act, S. 2152, 109th Cong. (2005); Streamlined Sales Tax Simplification Act, S. 2153, 109th Cong. (2005); Streamlined Sales Tax Fairness and Simplification Act, S. 34, 110th Cong. (2007); Sales Tax Fairness and Simplification Act, H.R. 3386, 110th Cong. (2007).

involved with the Project and it reaches its goals of uniformity and ease of administration, pushing for federal legislation becomes a necessity for the survival of e-commerce taxation.

B. *The Obstacles*

Those who created the Project knew from the outset that congressional action would not be easy. However, extensive work was done simplifying and unifying tax rules throughout the Project's membership to prove to Congress that progress could be and had been made. However, despite the Project's hard work and lofty goals, some obstacles remain. Even though the words of the *Quill* court have certainly been heeded, the work is not yet over. As one commentator noted, despite the activity at both the state and federal levels, any attempt at meaningful federal legislation must overcome diverse, competing interests that are unlikely to converge, along with the reticence of Congress to involve itself with state tax policy.¹²⁷

1. *Federalism*

Enacting federal legislation on a matter of state (read "local") importance has to first overcome the obstacle of federalism. Those who created our nation's system of government wanted to avoid a federal legislature involving itself in local matters.¹²⁸ Although the Project addresses issues of interstate commerce that have become increasingly poignant as the economy becomes less and less geographically bounded, its ultimate goal is to feed state coffers. Federal revenue is not directly affected by overturning *Quill*,¹²⁹ and no one wants to "add" taxes during a recession.¹³⁰

¹²⁷ John A. Swain, *Cybertaxation and the Commerce Clause: Entity Isolation or Affiliate Nexus?*, 75 S. CAL. L. REV. 419, 474 (2002).

¹²⁸ Isaacson testimony, *supra* note 78.

¹²⁹ Although, admittedly, a "trickle up" of problems resulting from states lacking the revenue to sustain their own budgets could result in increased federal aid to states. See Hamilton, *supra* note 48 at 627 (noting that dire economic conditions could actually improve the outlook for action on federal SSTP legislation by being spun as a "vehicle for helping the states cope with mounting budget problems.").

¹³⁰ Sen. Mike Enzi made this clear during his introduction of S. 2152 during the 109th Congress ("This bill is not about new taxes."). 151 CONG. REC. S14187 (daily ed. Dec. 20, 2005) (statement of Sen. Enzi). When testifying before a House subcommittee on H.R. 3386, Steven Rauschenberger, past president of the National Conference of State Legislatures, made clear to point out that consumers are already liable for use taxes on their online purchases. The efforts of the Project are to remove this burden from consumers and shift it to businesses that may more easily track and administer tax collection. Rauschenberger testimony, *supra* note 4.

2. *Self-Interests of Parties*

Furthermore, with so many parties necessary to make a congressional push effective, it is inevitable that each party's self-interest will overrule any goals of the Project. As mentioned above, approving taxation of non-nexus e-commerce sales does not affect federal revenue, and will likely be the cause of many angry constituents in any legislator's home district.¹³¹ Moreover, many businesses are already integrating their online and brick-and-mortar presences making the nexus problem of *Quill* a moot point.¹³² Therefore, a legislator may be angering his constituency and risking reelection to enact something with no real effect. What is his incentive to act?

Despite the recent interest of some states in joining the Project following the adoption of the origin-based sourcing option discussed above, the majority of states have still chosen not to become members of the Project.¹³³ The Direct Marking Association pointed out to a House subcommittee considering the issue that, should the legislation¹³⁴ be enacted, businesses nationwide would be subjected to sales tax collection duties for member states.¹³⁵ However, some businesses might not even be required to collect sales taxes in their own states, if their home states are not Project members.¹³⁶ By staying out of the Project, states protect their own businesses from sales tax liability elsewhere. A state, therefore, has an incentive to take a wait-and-see approach, rather than attempting to conform its tax code to the SSUTA. Without a large number of states involved, the Project will lose momentum with Congress.

¹³¹ Hamilton, *supra* note 48, at 627 (“Internet Sales Tax: What If There’s No There There?”).

¹³² Hamilton, *supra* note 48, at 627. Hamilton provides more information on this “multichannel retailing” and its benefits.

¹³³ Isaacson testimony, *supra* note 78 at 17. In fact, the six largest states in the nation (California, Texas, New York, Florida, Illinois, and Pennsylvania) are not Project members.

¹³⁴ The Direct Marking Association’s comments were focused on H.R. 3396, 110th Cong., Reg. Sess. (2007). *Id.*

¹³⁵ Isaacson testimony, *supra* at 17.

¹³⁶ *Id.* Isaacson provides a specific example: “an Internet retailer based solely in California or Massachusetts (neither of which are SSUTA members) would be subject [to] tax collection, reporting and remittance obligations for its sales to residents of Nebraska, North Carolina, Wyoming, and every other SSUTA state, but neither California nor Massachusetts would receive any additional tax revenue from an Internet retailer with operations solely in any of the SSUTA member states.”

3. *Can the Governing Board be Trusted to Govern?*

The federal Streamlined Sales Tax legislation has problems as well. The most recent version, S. 34,¹³⁷ introduced in 2007, gives the SSTP Governing Board the power to determine compliance issues arising under the SSUTA.¹³⁸ Given the importance of such a grant of power in a hotly contested area of law, raises concerns about the effectiveness of this structure. Under the SSUTA, the Governing Board has the power to sanction any member who is no longer in substantial compliance.¹³⁹

One scholar notes the flaws in the design of the Governing Board itself.¹⁴⁰ Neither the current board decision-making process on compliance review questions, nor the sanctions process, is well outlined.¹⁴¹ A state need only be in “substantial compliance” and sanctions may be imposed by a three-quarters vote of the board members.¹⁴² The possibility of these flaws in action is apparent in the recent deviation from a strict destination-based sourcing requirement for states that choose to slowly implement the change under the new origin-based sourcing option for intrastate sales.¹⁴³ Achieving uniformity among states and easing the burden on sellers will be difficult without an appropriately designed enforcement mechanism. The Governing Board’s ability to fill this role effectively is still disputed.

Because the Board is composed of representatives of the member states, the possibility for self-interested decision-making permeating the process is ever present.¹⁴⁴ The state representatives are appointed by their states; they are continually faced with the prospect of being replaced for not adequately representing their state’s interests.¹⁴⁵ As businesses band together to oppose painful changes, such as the change to destination-based sourcing, acting in the interests of the Project, rather than in the interests of a state’s constituency, becomes even more difficult. Although the states coming together to accomplish goals they could not accomplish on their own is admirable, the self-interest problem faced in enacting federal legislation is present within the Project itself. Thus, giving the Governing Board such a vital role in enforcing a national sales tax collection duty and relevant state compliance is troublesome.

¹³⁷ Sales Tax Fairness and Simplification Act of 2007, S. 34, 110th Cong. (2007).

¹³⁸ Sales Tax Fairness and Simplification Act of 2007, *supra* note 137, at § 4(c).

¹³⁹ Galle, *supra* note 25 at 1394.

¹⁴⁰ *Id.*

¹⁴¹ *Id.* at 1412-1413.

¹⁴² *Id.*

¹⁴³ See discussion above in Section III.

¹⁴⁴ Galle, *supra* note 25, at 1413-1420.

¹⁴⁵ *Id.*

C. *The Possibility of Court Action First*

Even without congressional action, the growth of the e-commerce industry may force the Court to readdress its earlier decision in *Quill*. Although the Court clearly requires more nexus than that established by simply making a few sales into a state,¹⁴⁶ it was unclear about what level of nexus might be sufficient to impose a sales tax collection duty.¹⁴⁷ Recent case developments are leading some to wonder whether the nexus standard established in *Quill* can withstand changes in modern business practices.

1. *Economic Nexus*

Some commentators have advocated the use of “economic nexus” to meet the constitutional requirements for a collection duty.¹⁴⁸ Under such a theory, simply delivering purchased goods into a state for final consumption would trigger nexus, enabling a state to impose tax collection duties.¹⁴⁹ Because every sale would create a presumption of taxability, the state’s power to tax would be greatly increased.¹⁵⁰ However, because of the administrative burdens that would be created under such a standard, some de minimis exemption would likely still be required.¹⁵¹

2. *Affiliate Nexus*

Some states use “affiliate nexus” to overcome the legal fiction that affiliated corporations, including those doing business online, are separate entities from their brick-and-mortar counterparts.¹⁵² However, some form of physical presence in the state is usually required in cases where courts have upheld the constitutionality of imposing tax collection duties on sellers without brick-and-mortar stores in the state,¹⁵³ usually through presence of an agency

¹⁴⁶ *Quill*, 504 U.S. at 313.

¹⁴⁷ Masterson, *supra* note 17, at 212.

¹⁴⁸ *Id.* at n. 54-56 (citing Charles E. McLure, Jr., *Taxation of Electronic Commerce: Economic Objectives, Technological Constraints and Tax Laws*, 52 TAX L. REV. 269, 295 (1997); Craig J. Langstraat & Emily S. Lemmon, *Economic Nexus: Legislative Presumption or Legitimate Proposition?*, 14 AKRON TAX J. 1, 1-2 (1999); and Matthew N. Murray, *Telecommunications Services and Electronic Commerce: Will Technology Break the Back of the Sales Tax?*, 1997 St. Tax Today (Jan. 30, 1997), at P39).

¹⁴⁹ Masterson, *supra* note 17, at 214.

¹⁵⁰ *Id.*

¹⁵¹ *Id.*

¹⁵² Andrew W. Swain & Nathaniel T. Trelease, *Taxing Time for the Internet?*, BUSINESS LAW TODAY Nov.-Dec. 2005, at 11.

¹⁵³ Swain, *supra* note 127, at 433 (citing *Scripto, Inc. v. Carson*, 362 U.S. 207, 208-09 (1960) (ten “specialty brokers” soliciting orders in the state); *Tyler Pipe Indus. V.*

relationship with someone in the state.¹⁵⁴ In addition, courts will find a nexus based on nothing more than an affiliation with an in-state retailer.¹⁵⁵

3. Associate Nexus?

A new wrinkle in the case law on affiliate and agency nexus has recently emerged in New York. Just this year, a New York State Supreme Court judge upheld a newly enacted New York law that imposes a sales tax collection duty on sellers that enter into referral agreements with New York residents.¹⁵⁶ Under the new law, enacted in April 2008,¹⁵⁷ any seller that solicits business through agreements with New York residents, where the residents refer customers to the seller and receive some form of consideration in return, and has more than \$10,000 in gross receipts in the state per year is subject to sales taxes on those referred sales.¹⁵⁸

Although Amazon.com challenged the constitutionality of the new law under the Commerce Clause,¹⁵⁹ arguing that its activities through its agreements with New York residents are insufficient to meet the substantial nexus standard under *Quill* and its progeny, the New York County Supreme Court upheld the law. Thus, even without an agency relationship with state residents, Amazon.com still has a duty to collect New York sales taxes. This decision is raising fears that its holding may undermine the efforts of the Project.¹⁶⁰ If states can rely on their own statutory schemes to collect taxes from online businesses, they will no longer need to be involved in the

Wash. Dep't of Revenue, 483 U.S. 232 (1987) (independent contractors soliciting sales in the state); *Standard Pressed Steel Co. v. Dep't of Revenue*, 419 U.S. 560, 562 (1975) (single employee continuing contractual relations and resolving post-sale difficulties with the seller's product in the state)).

¹⁵⁴ See *Borders Online, LLC v. State Bd. of Equalization*, 29 Cal. Rptr. 3d 176 (1st Dist. 2005).

¹⁵⁵ Andrew W. Swain & Nathaniel T. Trelease, *supra* note 153, at 14 (citing *Current Inc. v. Cal. Bd. of Equalization*, 29 Cal. Rptr. 2d 407 (1st Dist. 1994) & *SFA Folio Collections, Inc. v. Tracy*, 652 N.E.2d 693 (Ohio 1995)).

¹⁵⁶ *Amazon.com LLC v. New York State Dep't of Taxation and Finance*, No. 601247/08, slip op. (N.Y. Gen. Term Jan. 12, 2009) (challenging constitutionality of N.Y. TAX LAW § 1101 (McKinney 2008)).

¹⁵⁷ 2008 N.Y. Sess. Laws Chapter 57 (McKinney).

¹⁵⁸ *Id.*

¹⁵⁹ Under the test established by *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1997), a state may only collect taxes on an activity with a "substantial nexus" with the taxing state.

¹⁶⁰ Dolores W. Gregory & J.P. Finet, *Electronic Commerce: New York's Win in 'Amazon.com' Raising Fears of Impact on SSTP Project*, DAILY REPORTS FOR EXECUTIVES (BNA) (Jan. 15, 2009).

Project.¹⁶¹ An appeal of this case by Overstock.com, still pending,¹⁶² will be important in determining the effects on the future of the Project's efforts.

As the economy becomes more unlike that of the era when sales and use taxes were first enacted,¹⁶³ cases challenging the current jurisprudence on nexus standards are likely to become more common. Given the recent pressures on states' budgets and the need for additional resources, the restraints on nexus may be lessened more and more. It seems probable that, as our economic reality changes, so must our judicial reality. However, as the Supreme Court noted in *Quill*, it would prefer that the legislature take the lead.

D. *The Future*

As the obstacles remain in place, the Project is ramping up its push on Congress to take action in response to the Supreme Court's direction in *Quill*.¹⁶⁴ For some, the recent changes to the agreement's sourcing rules that will allow some of the Project's big players (i.e. Tennessee and Ohio) to remain members and possibly draw in new states¹⁶⁵ are a big break that puts even more pressure on Congress to act. However, for others, deviating from one of the Project's core original principals (mandatory destination-based sourcing), signals the inevitable weakening and ultimate defeat of the Project itself.¹⁶⁶

The states' budget crises may be the best impetus for federal action. States across the country are being forced to slash state budgets, resort to accounting gimmicks, and plead for federal assistance in order to meet their

¹⁶¹ *Id.* (Comment of Fred Nicely, tax counsel for the Council on State Taxation).

¹⁶² *Id.* (Noting news release on January 13 of Overstock.com's intention to appeal).

¹⁶³ Sales taxes became widely used beginning in the 1930's. 68 AM. JUR. 2D *Sales and Use Taxes* § 2 (2008).

¹⁶⁴ As mentioned previously in Section II.C, as of November 2008, the Project was advertising for an experienced lobbyist to assist in their efforts in Washington. See RFP, *supra* note 53.

¹⁶⁵ See Hamilton, *supra* note 42, at 56-57 ("The December compromise represents a major about-face...[T]hat single stroke...could pave the way to membership for other states, including Arizona, California, Florida, Illinois, Missouri, New Mexico, Pennsylvania, Texas, and Virginia."); Parker, *supra* note 64, at 806 (noting the importance of the sourcing issue to Tennessee, Virginia, Missouri, and Texas).

¹⁶⁶ Isaacson statement, *supra* note 78, at 12 ("[T]he Governing Board has tolerated, at times even encouraged, blatant departures from the substance and spirit of the SSUTA on the part of state governments in order to avoid members states from withdrawing, or being disqualified, from membership in the SSUTA.") See also Galle, *supra* note 25, at 1387-94 (noting the many flaws in the governance system of the Project); Hamilton, *supra* note 42, at 57 (citing the Direct Marketing Association's comment that the Governing Board's approval of the origin-based sourcing option for intrastate sales is "an enormous step backward in sales tax simplification.").

basic needs.¹⁶⁷ However, amid calls for enactment of enabling legislation in a federal stimulus plan,¹⁶⁸ it seems that President Obama is unlikely to include such a provision in his plan at this time.¹⁶⁹

Ultimately, Congress must be convinced that passing streamlined sales tax legislation is in their best interest both politically and as a matter of public policy. To overturn a Supreme Court decision at the suggestion of states (seen by many as merely trying to increase their state coffers) is no small task. Every legislator approached with this legislation surely has many issues in his mind—concerns about federalism, the governance of the Project, and the perception of imposing new or additional taxes in an economic downturn. Certainly more states need to come on board before any federal action is taken. Big states, such as Virginia, California, and Texas, must buy into the idea of streamlining sales taxes before the legislature will resurrect pre-*Nat'l Bellas Hess* sales taxation.

V. CONCLUSION: HOW TO PLAN FOR AN UNCERTAIN FUTURE

The Streamlined Sales Tax Project is an unprecedented cooperative effort among states to make wholesale changes in their tax laws—sometimes to their own competitive disadvantage and harmful to their own businesses—in order to modernize the collection of sales and use taxes nationwide. However, the events of the past several years foretell different things to different people. To some, the apparent resolution of the destination-based sourcing dilemma that threatened to cause withdrawal by some of the Project's most important players spells hope for future federal action. Now that more states may be inclined to participate, and indeed, many are actively pursuing participation that would not have done so before the most recent amendment to the Agreement, the voices calling to Congress for action are growing louder.

For others, this deviation from one of the Project's core principles shows that a uniform system is not achievable.¹⁷⁰ The words of *Quill* become

¹⁶⁷ *Web as Tax Haven: A Tax System Also Must Keep Pace with a Changing Economy*, AKRON BEACON J., Jan. 16, 2009, at A8.

¹⁶⁸ The Council on State Taxation (COST) advocated for the inclusion of the federal Streamlined Sales Tax provisions into any stimulus package in any economic stimulus package during the current congressional session. Letter from Council on State Taxation et al., to congressional leadership, Coalition Letter Urging Inclusion of SST in Stimulus Package (Jan. 9, 2009), available at <http://www.statetax.org/StateTaxLibrary.aspx?id=17546> (last visited Jan. 9, 2009).

¹⁶⁹ Seth Tupper, *Web Tax Plan May Be Unlikely in '09, Delegates Say*, THE DAILY REPUBLIC (Mithcell, SD), Jan. 15, 2009 (statement of Sen. Tim Johnson, D-SD).

¹⁷⁰ As a further example of the Project's increasing flexibility on its uniformity standards for the sake of increasing membership, see Ross, *supra* note 43, at 5 (citing the Governing Board's preliminary approval of the Massachusetts price threshold for clothing).

truer as outsiders see the Project continuously compromise in order to achieve its goals and maintain its existence. Non-participating states that have seen the political upheaval caused in states that have joined the Project and conformed to the Agreement's provisions may still be wary of joining a group whose efforts may be for naught. Self-interest will always control, and overcoming the flaws in this system is crucial.

If the life of the Project thus far gives any lessons, it is "wait and see." Complying with legal changes too soon has left businesses in the lurch, and the Project has proven that, with enough moaning and groaning, its "mandatory" requirements can be waived. Any impetus for congressional action will have to come from the continually falling state revenues¹⁷¹ and the need to fund vital government services, especially in this economic climate.¹⁷² Therefore, businesses should be ever mindful of the possibility that the Project will succeed, albeit at some point in the distant future.

¹⁷¹ Sen. Mike Enzi, sponsor of S. 2152 during the 109th Congress, highlighted this aspect of the federal legislation in his remarks to Congress ("The bill will also help States begin to recover from years of budgetary shortfalls.") 151 CONG. REC. S14187 (daily ed. Dec. 20, 2005) (statement of Sen. Enzi).

¹⁷² Letter from Council on State Taxation et al., to congressional leadership (Jan. 9, 2009), *supra* note 168, at A8.