

**ELIMINATING THE E-COMMERCE SALES TAX  
ADVANTAGE IN THE UNITED STATES BY FOLLOWING  
IN THE FOOTSTEPS OF THE EUROPEAN UNION**

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## INTRODUCTION

Each year billions of tax dollars due on internet sales are not collected under the current United States tax system.<sup>1</sup> The amount of uncollected tax on internet sales is expected to rise each year as e-commerce continues its rapid growth.<sup>2</sup> E-commerce sales reached \$2,385 billion in 2006, and a recent study conducted at the University of Tennessee suggests that e-commerce sales could rise to more than \$3.5 trillion in 2012.<sup>3</sup> Not collecting the tax on these sales leaves a lot of potential government revenue on the table. It is estimated that these losses totaled \$7.7 billion in 2008, and could rise to \$11.4 billion by 2012.<sup>4</sup> The frustrating aspect of these losses is that they are not the result of the elimination of a tax but rather are the result of an inadequate method to collect the tax.<sup>5</sup>

Collecting tax on all internet sales would be beneficial to the US economy for several reasons. First, since sales taxes are collected by the states, the collection of the taxes could address state budget shortcomings.<sup>6</sup> Second, it would level the retail playing field by eliminating the unjustified tax advantage that internet retailers receive over brick-and-mortar retailers. Currently, some customers purchase items from online retailers rather than brick-and-mortar stores simply because they can avoid paying a sales tax. An efficient tax system should not influence economic decisions in this way.<sup>7</sup> Rather, an individual consumer's purchasing decisions should be based solely on the product or service offered by the retailer and not on whether a consumer receives "beneficial" tax treatment from the government.<sup>8</sup> Third, nexus<sup>9</sup> and its

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<sup>1</sup> DONALD BRUCE ET AL., STATE AND LOCAL GOVERNMENT SALES TAX REVENUE LOSSES FROM ELECTRONIC COMMERCE, at ii (2009).

<sup>2</sup> *Id.*

<sup>3</sup> *Id.* at 1–2.

<sup>4</sup> *Id.* at 7.

<sup>5</sup> See *Internet Sales Tax Fairness—European Union*, INST. FOR LOC. SELF-RELIANCE (Dec. 2, 2002), <http://www.newrules.org/node/2241> [hereinafter ILSR].

<sup>6</sup> See David Combs, *State Budget Gaps: How Does Your State Rank?*, STATELINE (Mar. 15, 2011), <http://www.pewstates.org/projects/stateline/headlines/state-budget-gaps-how-does-your-state-rank-85899375024> (listing the current state budget deficits on a state-by-state basis in regards to total amount of deficit and deficit as percent of 2011 spending).

<sup>7</sup> See MICHAEL J. GRAETZ, *THE U.S. INCOME TAX: WHAT IT IS, HOW IT GOT THAT WAY, AND WHERE WE GO FROM HERE* 10 (1999).

<sup>8</sup> See *id.*

relationship to the collection of sales tax would have less of an influence on corporate decision making; especially those decisions relating to the elimination and creation of jobs.<sup>10</sup> Recently, retailers have moved warehouses and other corporate operations to avoid litigation over nexus and tax collection in certain states.<sup>11</sup> Again, this conflicts with the basic policy principals that a tax system should not interfere with economic decisions and should facilitate growth<sup>12</sup> and is particularly harmful given the importance of job security in the current US economy.<sup>13</sup> With the unemployment rate hovering around 9 percent in 2011, it is important that the US government eliminate incentives, like this internet tax loophole, for corporations to eliminate jobs.<sup>14</sup> Eliminating this loophole could become one part of the US's effort to encourage economic growth and create jobs.

In contrast to the United States, the European Union has implemented a system that requires an internet retailer to collect Value Added Tax ("VAT") on internet sales.<sup>15</sup> The European Union does this through a simplified system that makes it easier for both large and small retailers to collect VAT on all internet sales.<sup>16</sup> Although certain differences make it impossible for the United States to adopt a system identical to the European Union, the United States should be able to adopt several of the prominent features of the EU's system of collecting

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<sup>9</sup> Quill Corp. v. North Dakota, 504 U.S. 298, 313 (1992) (opining that nexus essentially means that the retailer must have a substantial physical presence in the taxing state).

<sup>10</sup> *Id.* at 318 (holding that a retailer does not have to collect sales tax on mail order sales unless there is nexus between the retailer and the state).

<sup>11</sup> See Janet Novack, *Are Amazon.com's Days of Tax Free Selling Numbered?*, FORBES (Feb. 27, 2011), <http://www.forbes.com/sites/janetnovack/2011/02/27/are-amazon-coms-days-of-tax-free-selling-numbered/>.

<sup>12</sup> See GRAETZ, *supra* note 7, at 10.

<sup>13</sup> See Novack, *supra* note 11 (discussing that large retailers may shut down large distribution centers or other corporate locations simply to avoid nexus and leave a large number of individuals unemployed).

<sup>14</sup> See *Labor Force Statistics from the Current Population Survey*, BUREAU OF LABOR STATISTICS, <http://data.bls.gov/timeseries/LNS14000000> (last visited Dec. 1, 2011) (the average unemployment rate in 2011 has been 8.99% through the first eleven months and the rate has ranged from 8.6% to 9.2%. In comparison, ten years ago, in 2001, the average unemployment rate was 4.74 and the rate ranged from 4.2% to 5.7%).

<sup>15</sup> ILSR, *supra* note 5 (describing that the Value Added Tax in the EU is a close equivalent to sales tax in the U.S., with basically a different way of collecting/charging the VAT). For additional discussion of VAT, see *infra* Part IV.

<sup>16</sup> *Id.* For instance, they provide computer software to assist in the collection of VAT and charge origin rate on services and smaller purchases of goods. See *infra* Part IV for a more detailed discussion of the EU VAT system and its benefits.

tax on internet sales.<sup>17</sup> The most important features of the EU's system are simplicity, fairness, and cooperation.

The similarities between the United States and the European Union suggest that the United States should be able to adopt a system that adequately taxes internet sales. The United States and the EU nations are both developed and have many similar resources. Further, the EU demonstrates that many of the fears that those in the United States have about implementing such a system are not as problematic as the businesses and politicians opposing such a system think.<sup>18</sup>

In this paper, I will compare the sales taxes of the US states with the VAT of EU member countries that is charged to private individuals. Because sales tax is paid on the retail sale of the item in the United States and not on goods purchased for inventory, there is nothing in the US tax system to compare with the VAT that the European Union charges on sales between businesses. Therefore this paper does not focus on VAT charged to businesses.

Part I of this paper gives an overview of how the current US tax system deals with the collection of taxes on internet sales. Part I also discusses recent litigation regarding taxation on internet sales and legislative efforts to implement a system that more effectively collects tax on internet sales. Part II gives an overview of how the EU tax system deals with tax on internet sales and discusses the legislation used to implement this system. Part III takes a closer look at why the United States should adopt a system similar to the EU. Part IV examines how the United States could adopt a similar system and what major policies the United States should take from the European Union such as fairness, simplicity, and cooperation. This section also discusses challenges inherent in adopting such a system. Finally, the conclusion summarizes why the United States should implement the policies of fairness, simplicity, and cooperation in the US system like the European Union did.

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<sup>17</sup> For instance, the U.S. would not be able to adopt the EU's policy of charging origin on certain types of sales because certain states in the U.S. do not have a sales tax, therefore, retailers would be influenced to move to those states, which would signify an inefficient tax policy. See FEDERATION OF TAX ADMINISTRATORS, STATE SALES TAX RATES AND FOOD & DRUG EXEMPTIONS (2011), available at <http://www.taxadmin.org/fta/rate/sales.pdf>.

<sup>18</sup> Many in the U.S. fear that implementing such a system will be too complex for small retailers, but the EU has shown that it is possible with a little simplification and assistance on the governments end. See JEFFREY A. EISENACH & ROBERT E. LITAN, UNCOLLECTED SALES TAXES ON ELECTRONIC COMMERCE: A REALITY CHECK, at ii (2010) (discussing the cost and complexity of implementing a system in the US).

## I. TAXING INTERNET SALES UNDER THE CURRENT US SYSTEM

### A. GENERAL OVERVIEW

Sales tax is implemented at the state and local levels of government in the United States.<sup>19</sup> Currently, forty-five states charge sales taxes on various types of retail sales.<sup>20</sup> Of these states, thirty-three of them authorize local governments to collect various forms of sales tax.<sup>21</sup> The combination of state and local sales tax regulations results in more than 7,500 taxing jurisdictions imposing some form of sales tax in the US.<sup>22</sup>

Citizens are technically supposed to pay tax on all internet purchases under current US law.<sup>23</sup> However, unless the retailer is required to collect this tax due to nexus, individuals are supposed to self-report and pay the tax themselves.<sup>24</sup> Most consumers do not self-report tax on their internet purchases.<sup>25</sup> Consumers can easily avoid reporting this because the states do not pursue collecting the tax due to how cost-ineffective it would be.<sup>26</sup> For most purchasers, this is considered one of the benefits of purchasing items online.

The tax that US citizens are supposed to pay and report on their internet purchases from retailers that do not collect sales tax is called an equivalent use tax.<sup>27</sup> By definition, a use tax is a “tax imposed on the use of certain goods that are bought outside the taxing authority’s jurisdiction.”<sup>28</sup> The use tax is essentially the same as the sales tax except that it requires the consumer, rather than the retailer, to report the tax and

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<sup>19</sup> BUSINESS LAWS INC., CORPORATE COUNSEL’S GUIDE TO WEB SITE AGREEMENTS, § 6:25 (2011) [hereinafter CORPORATE COUNSEL’S GUIDE].

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> Robert W. Wood, *Amazon Tax Attacks*, FORBES (Mar. 15, 2011), <http://www.forbes.com/sites/robertwood/2011/03/15/amazon-tax-attacks/>.

<sup>24</sup> *Id.*

<sup>25</sup> MICHAEL MAZEROV, CENTER ON BUDGET AND POLICY PRIORITIES, NEW YORK’S “AMAZON LAW”: AN IMPORTANT TOOL FOR COLLECTING TAXES OWED ON INTERNET PURCHASES 4 (2009), available at <http://www.cbpp.org/files/7-23-09sfp.pdf>.

<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> BLACK’S LAW DICTIONARY 1597 (9th ed. 2009).

submit the amount due.<sup>29</sup> The impact on taxpayers that pay these taxes is essentially the same because tax rates are the same for both.<sup>30</sup>

States have relied on use taxes to collect tax on internet sales because they are often prohibited from requiring out-of-state retailers to collect sales tax.<sup>31</sup> Unfortunately, these efforts have been largely ineffective.<sup>32</sup> This is mainly because most consumers do not know about the tax, consumers think the amount due is too small to justify the paperwork, and the consumers know that the states have been lax in enforcing payment on the use tax.<sup>33</sup>

Internet retailers are, however, required to collect sales tax on items sold to consumers in states where the retailer has a substantial nexus.<sup>34</sup> *Quill Corp. v. North Dakota* is the landmark case establishing that a retailer needs to have substantial nexus with the consumer's state of residence for there to be a requirement to collect sales tax.<sup>35</sup> The Supreme Court determined that substantial nexus essentially means that the retailer must have a *substantial physical presence* in the taxing state.<sup>36</sup> There has been extensive litigation between retailers and state governments over whether those retailers have substantial nexus with the state.<sup>37</sup> Additionally, it has led retailers to remove distribution centers and offices from certain states to avoid meeting the substantial nexus requirement.

The substantial nexus requirement can lead to several inequalities. It puts brick-and-mortar<sup>38</sup> and click-and-mortar<sup>39</sup> retailers at

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<sup>29</sup> Compare WIS. STAT. § 77.52 (2009–10) (Wisconsin statute governing the imposition of retail sales tax), with WIS. STAT. § 77.53 (2009–10) (Wisconsin statute governing the imposition of use tax).

<sup>30</sup> Compare WIS. STAT. § 77.52, with WIS. STAT. § 77.53.

<sup>31</sup> CORPORATE COUNSEL'S GUIDE, *supra* note 19, § 6.27.

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> See *Quill Corp. v. North Dakota*, 504 U.S. 298, 301 (1992).

<sup>35</sup> See *id.* at 312.

<sup>36</sup> *Id.* at 313.

<sup>37</sup> See, e.g., *St. Tammany Parish Tax Collector v. Barnesandnoble.com*, 481 F. Supp. 2d 575 (E.D. La. 2007).

<sup>38</sup> A brick-and-mortar retailer is a retailer that makes all of its sales from physical stores with face-to-face interaction with customers. These types of businesses are stereotypically thought of as your main street mom-and-pop shops. *Definition of Brick-and-Mortar*, MERRIAM-WEBSTER, <http://www.merriam-webster.com/dictionary/brick-and-mortar> (last visited Apr. 2, 2013).

<sup>39</sup> A click-and-mortar retailer is a retailer that makes sales through both its physical stores with face-to-face interaction with customers and through its retail website. Some examples of this type of business are Wal-Mart and Target. PHILLIP KOTLER & GARY ARMSTRONG, *PRINCIPLES OF MARKETING* 85 (10th ed. 2003).

a significant disadvantage when compared to click-only<sup>40</sup> retailers.<sup>41</sup> The 5-10 percent worth of sales tax that “brick” companies must charge may not seem like a lot, but when inherently narrow profit margins in the retail industry are taken into account, it is plain to see why local “brick” businesses struggle to compete against internet retailers.<sup>42</sup> Another argument raised in opposition to the “click-only advantage” is that the internet retailers use state funded resources to assist them in commerce while at the same time do not collect sales tax that would be used to fund those resources.<sup>43</sup> Some examples of the resources used by the internet retailers are the construction and maintenance of roads, state consumer protection agencies, and police and fire protection.<sup>44</sup> The loophole also disproportionately affects lower-income households as research shows that low-income consumers are less likely to shop online than more affluent consumers.<sup>45</sup>

There are also several common arguments against the implementation of a system that collects tax on all internet sales.<sup>46</sup> Most of these arguments have to do with cost and complexity.<sup>47</sup> Those in opposition to the tax claim that it would impose significant administrative costs on businesses by requiring them to abide by the tax laws of each state they have a purchaser in.<sup>48</sup> Many feel that this would be especially harmful to small businesses because they may not generate enough revenue to offset these high costs and make the business viable.<sup>49</sup> The fixed costs<sup>50</sup> they would incur may be too high when compared with the limited sales of the business.<sup>51</sup> Unlike a small business, a large retailer would have an easier time covering the fixed costs as they have

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<sup>40</sup> A click-only retailer is a retailer that makes all of its sales through its retail website. Some examples of this type of business are Amazon.com and Overstock.com. *Id.* at 82.

<sup>41</sup> See MAZEROV, *supra* note 25 at 3.

<sup>42</sup> *Id.*

<sup>43</sup> See *id.*

<sup>44</sup> *Id.*

<sup>45</sup> *Id.* at 2.

<sup>46</sup> See EISENACH & LITAN, *supra* note 18, at ii.

<sup>47</sup> *Id.*

<sup>48</sup> *Id.*

<sup>49</sup> *Id.*

<sup>50</sup> Fixed costs are costs that do not vary with the amount of goods or services produced. In this case, fixed costs would mostly include the cost of setting up and maintaining a system to determine and keep record of the sales tax. This may include software costs, attorney and tax professional fees while setting up the system, and the salary of additional employees to operate with system. See JERRY J. WEYGANDT ET AL., *MANAGERIAL ACCOUNTING: TOOLS FOR BUSINESS DECISION MAKING* 192–93 (3d ed. 2005).

<sup>51</sup> See EISENACH & LITAN, *supra* note 18, at ii.

more sales to distribute the fixed costs amongst.<sup>52</sup> The fear of administrative costs and complexity comes from the fact that each state has its own tax code.<sup>53</sup> This means that a retailer would have to keep track of the rates in each state in which they have consumers purchase goods from them and submit the correct amounts to each state when due.<sup>54</sup> In conjunction with this, there is also the issue of verifying the taxpayer's residence so that the correct rate can be applied.<sup>55</sup>

### B. LEGISLATIVE EFFORTS TO FIX THE TAX LOOPHOLE

In recent years there have been a number of bills introduced at both the state and federal level attempting to close the loophole that allows internet retailers to avoid collecting sales tax when they do not have nexus with the consumer's state. These proposed laws are often called "Amazon Law's" or "Amazon Taxes"; named after the large internet retailer.<sup>56</sup> Large retailers like Wal-Mart, Best Buy, and Target continue to push legislators to close the loophole that allows retailers like Amazon to avoid collecting sales tax.<sup>57</sup> Retailers such as these are at a competitive disadvantage when competing against companies like Amazon because their brick-and-mortar stores give them nexus with states, which requires them to collect sales tax on all of their internet and in-store sales.

States have continued to introduce bills attempting to close the loophole with varying results. New York, Rhode Island, North Carolina, Illinois, Arkansas, Connecticut, California, South Dakota and Colorado are among the states that have passed legislation addressing the loophole.<sup>58</sup> The corporations negatively affected by this type of legislation, such as Amazon, have filed suit in federal court challenging

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<sup>52</sup> With an increased number of sales the percentage of each sale that goes to cover fixed costs is reduced, and thus the profit margin on each sale increases.

<sup>53</sup> Isaac J. Morris, *Creating an Online Internet Tax: A Complex Construction?*, 2 NW. J. TECH. & INTEL. PROP. 291, 306 (2003), available at <http://www.law.northwestern.edu/journals/njtip/v2/n2/v2n2.pdf>.

<sup>54</sup> See *id.* at 304.

<sup>55</sup> See *id.* at 306.

<sup>56</sup> MAZEROV, *supra* note 25, at 1.

<sup>57</sup> Marc Lifsher, *Amazon Offers to Serve as Tax Collector – For a Price*, L.A. TIMES (Nov. 3, 2011), <http://articles.latimes.com/2011/nov/03/business/la-fi-amazon-tax-collect-20111103>.

<sup>58</sup> *Internet Sales Tax Fairness*, INST. FOR LOC. SELF-RELIANCE, <http://www.ilsr.org/rule/internet-sales-tax-fairness/> (last visited March 30, 2013).



the constitutionality of many of these “Amazon Taxes.”<sup>59</sup> The big issue in these suits is whether the retailers affected by the legislation meet the “substantial nexus” requirement set forth in *Quill*.<sup>60</sup> Some states, like New York, have attempted to establish “substantial nexus” through the independent in-state websites that the out-of-state retailers use to promote their sales.<sup>61</sup> Several state courts have ruled that this method of establishing “substantial nexus” is constitutional.<sup>62</sup>

In 2002, a state-led initiative established the Streamlined Sales and Use Tax Agreement in an effort to simplify and align sales tax policies among the states.<sup>63</sup> This in turn would reduce the burden of tax compliance and make the implementation of a system to tax internet sales more feasible.<sup>64</sup> The agreement focuses on improving sales and use tax administration through the following: (1) state level administration of sales and use tax collection; (2) uniformity in the state and local tax bases; (3) uniformity of major tax base definitions; (4) central, electronic registration system for all member states; (5) simplification of state and local tax rates; (6) uniform sourcing rules for all taxable transactions; (6) simplified administration of exemptions; (7) simplified tax returns; (8) simplification of tax remittances; and (10) protection of consumer privacy.<sup>65</sup> There are currently twenty-two states<sup>66</sup> that are full members of the agreement and two states<sup>67</sup> that are associate members.<sup>68</sup>

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<sup>59</sup> *E.g.* Amazon.com, LLC v. N.Y. State Dep’t of Tax’n & Fin., 913 N.Y.S. 2d 129 (App. Div. 2010); Direct Mktg. Ass’n v. Huber, No. 10-CV-01546-REB-CBS, 2011 WL 250556 (D. Colo. filed Jan. 26, 2011).

<sup>60</sup> *Direct Mktg. Ass’n*, 2011 WL 250556, at \*4.

<sup>61</sup> MAZEROV, *supra* note 25, at 1.

<sup>62</sup> *Id.*

<sup>63</sup> *About Us*, STREAMLINED SALES TAX GOVERNING BOARD, INC., <http://www.streamlinedsalestax.org/index.php?page=About-Us/> (last visited Nov. 3, 2011) [hereinafter STREAMLINED].

<sup>64</sup> *Id.*

<sup>65</sup> STREAMLINED SALES TAX GOVERNING BOARD, INC., STREAMLINED SALES AND USE TAX AGREEMENT art. I, § 102 (2002), *available at* <http://www.streamlinedsalestax.org/index.php?page=modules> (follow “SSUTA as amended 5/24/2012” hyperlink) [hereinafter SSUTA].

<sup>66</sup> Arkansas, Indiana, Kansas, Michigan, Nebraska, New Jersey, North Dakota, Rhode Island, Vermont, West Virginia, Wyoming, Georgia, Iowa, Kentucky, Minnesota, Nevada, North Carolina, Oklahoma, South Dakota, Washington, Wisconsin, and Utah. *State Info*, STREAMLINED SALES TAX GOVERNING BOARD, INC., <http://www.streamlinedsalestax.org/index.php?page=state-info> (last visited Apr. 2, 2013).

<sup>67</sup> Ohio and Tennessee. *Id.*

<sup>68</sup> An associate member is “one that has been determined by the Streamlined Sales Tax Governing Board to: (a) either be in compliance with the Agreement, except that changes to their statutes and rules are not all in effect at this time; or (b) in compliance with nearly all parts of the

There have also been efforts at the federal level to implement a system that enables state governments to better collect tax on internet sales. In July 2011, Illinois Senator Dick Durbin introduced the Main Street Fairness Act.<sup>69</sup> All states participating in the proposed act would have to sign on to the Streamlined Sales and Use Tax System.<sup>70</sup> States would still be able to designate what goods are taxed and what the taxable rate is, but they would have to abide by certain rules that provide uniform definitions and govern how and when things can be changed.<sup>71</sup> This legislation required that a uniform rule be developed to establish a “smaller seller exception” that would exempt smaller businesses from having to follow the tax collection rules “authorized by th[e] Act.”<sup>72</sup>

## II. TAXING INTERNET SALES IN THE EUROPEAN UNION

### A. GENERAL OVERVIEW

The member countries of the European Union use Value Added Tax (“VAT”) rather than sales tax.<sup>73</sup> The basis of the value added to a good or service at each stage of the production and distribution chain determines the tax.<sup>74</sup> The tax is collected through a system of partial payments which allows firms to deduct from their VAT accounts the amount of tax that they paid on their commercial purchases.<sup>75</sup> This system makes the tax neutral no matter how many transactions were made.<sup>76</sup> The important thing to note, and what makes it comparable to the US sales tax, is that the VAT is paid by the final consumer based upon a percentage addition to the final price of the good or service.<sup>77</sup> The

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Agreement.” *What is an Associate Member State & Are Sellers Required to Register With Them?*, STREAMLINED SALES TAX GOVERNING BOARD, INC., [http://www.streamlinedsalestax.org/index.php?page=gen\\_20](http://www.streamlinedsalestax.org/index.php?page=gen_20) (last visited Apr. 2, 2013). In addition to full and associate members, a “contingent member” signifies that the state plans on becoming full members within the next twelve months. For additional discussion of member status, see SSUTA, *supra* note 65, art. VIII, §§ 801.1–801.3.

<sup>69</sup> Main Street Fairness Act, S. 1452, 112th Cong. (2011).

<sup>70</sup> *See id.* §§ 6(a)(1)–(8).

<sup>71</sup> *See id.* § 7(a)(2).

<sup>72</sup> *Id.* § 6(a)(16).

<sup>73</sup> *Summaries of EU Legislation: Common System of Value Added Tax (VAT) (‘the VAT Directive’)*, EUROPA.EU, [http://europa.eu/legislation\\_summaries/taxation/131057\\_en.htm](http://europa.eu/legislation_summaries/taxation/131057_en.htm) (last updated Feb. 4, 2011) [hereinafter *Common System of VAT*].

<sup>74</sup> *Id.*

<sup>75</sup> *Id.*

<sup>76</sup> *Id.*

<sup>77</sup> *Id.*

supplier of the good or service then submits the VAT paid to the national tax administration.<sup>78</sup>

Unlike the United States, the European Union has some involvement in countries setting their VAT rates.<sup>79</sup> The European Union felt that this was necessary to achieve the goal of promoting a single market and fair competition.<sup>80</sup> If there was no minimum VAT, member countries could eliminate their VAT, or set a low VAT, to stimulate sales within their country, forcing other member countries to lower their VAT to be competitive.<sup>81</sup> This would in turn lead to a decrease in much needed revenue to the member countries.<sup>82</sup> Currently, there is a normal 15 percent minimum VAT rate and a 5 percent reduced rate for special situations.<sup>83</sup>

The European Union addressed the issue of taxation on online purchases through legislation in May 2002 with Council Directive 2002/38<sup>84</sup> in the form of an amendment to the Sixth VAT Directive.<sup>85</sup> The objective of the amendment was to create a level playing field for EU businesses with respect to the indirect taxation of electronic commerce.<sup>86</sup> While promoting fairness, it was also the EU's goal to make compliance for businesses, including non-EU businesses, as easy and straightforward as possible.<sup>87</sup> These objectives fall in line with the EU's overriding purpose to promote a single market and fair competition.<sup>88</sup>

Council Directive 2002/38<sup>89</sup> dealt primarily with the modernization of existing VAT place-of-supply rules for services provided through electronic commerce.<sup>90</sup> The rules as originally written

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<sup>78</sup> *Id.*

<sup>79</sup> *See id.*

<sup>80</sup> *Id.*

<sup>81</sup> *See id.*

<sup>82</sup> *See id.*

<sup>83</sup> *Common System of VAT*, *supra* note 73.

<sup>84</sup> *VAT: Special Arrangements Applicable to Services Supplied Electronically*, EUROPA.EU, [http://europa.eu/legislation\\_summaries/consumers/protection\\_of\\_consumers/131044\\_en.htm](http://europa.eu/legislation_summaries/consumers/protection_of_consumers/131044_en.htm). (last updated Feb. 20, 2011) [hereinafter *Services Supplied Electronically*]; Council Directive 2002/38, 2002 O.J. (L 128) (EC).

<sup>85</sup> *Services Supplied Electronically*, *supra* note 84; Council Directive 77/388, 1978 O.J. (L 145) (EC).

<sup>86</sup> *Services Supplied Electronically*, *supra* note 84.

<sup>87</sup> *Id.*

<sup>88</sup> *Common System of VAT*, *supra* note 73.

<sup>89</sup> Council Directive 2002/38, 2002 O.J. (L 128) (EC).

<sup>90</sup> *Services Supplied Electronically*, *supra* note 84.

did not adequately address this issue, and led to unfair advantages.<sup>91</sup> Under the old rules, services that were electronically delivered from the EU were subject to VAT no matter what, and services delivered to the EU from a non-member country were not subject to VAT.<sup>92</sup> The principal changes under the directive concern the place of taxation for services supplied electronically.<sup>93</sup> The directive made electronically delivered services, supplied by non-EU retailers to customers residing in the EU, subject to VAT.<sup>94</sup> Additionally, the directive established that electronically delivered services supplied by EU retailers to non-EU customers are not subject to EU VAT.<sup>95</sup>

The Sixth VAT Directive and its amendments were recast in 2006 in the form of Directive 2006/112 and became effective on January 1, 2007.<sup>96</sup> Under the rules now embodied in Directive 2006/112,<sup>97</sup> the type and the size of the online purchase dictate which nation's VAT the private individual pays.<sup>98</sup> If a private individual living in an EU nation purchases a good online from a retailer in a different EU nation, and does not meet the annual purchase threshold (EUR 35,000 or EUR 100,000 depending on the country), they pay the origin VAT rate.<sup>99</sup> If the private individual meets or exceeds the purchase threshold, they pay the destination VAT rate.<sup>100</sup> The origin rate is charged on services purchased online by private individuals.<sup>101</sup>

The EU's system deals with sales to-and-from non-member countries in a fashion that promotes fair competition. When an EU retailer sells an item to a consumer in a non-EU country, the retailer does not charge any VAT.<sup>102</sup> This way, EU retailers can be competitive in non-EU member markets. If they would have to charge VAT they would be overpriced in comparison to the competition and would have trouble making sales. Similarly, the European Union requires consumers

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<sup>91</sup> *Id.*

<sup>92</sup> *Id.*

<sup>93</sup> *Id.*

<sup>94</sup> *Id.*

<sup>95</sup> *Id.*

<sup>96</sup> *Common System of VAT, supra note 73.*

<sup>97</sup> Council Directive 2006/112, 2006 O.J. (L 347) (EC).

<sup>98</sup> *Common System of VAT, supra note 73; Services Supplied Electronically, supra note 84.*

<sup>99</sup> *See id.*

<sup>100</sup> *Id.*

<sup>101</sup> *Id.*

<sup>102</sup> *Id.*

purchasing items from outside the European Union to pay VAT.<sup>103</sup> This way retailers from outside the European Union are not given a competitive advantage over retailers located in the European Union.

The EU's system also makes it easy for non-EU retailers to comply with VAT reporting requirements. When a non-EU retailer sells to an EU business, they have no VAT obligation at all because the EU business is required to account for the VAT themselves.<sup>104</sup> For non-EU businesses selling to final consumers, Council Directive 2002/38<sup>105</sup> created a simple scheme where they are only required to register with a single EU member country, even if they retail to several other EU member countries.<sup>106</sup> The retailer then charges the customer VAT on all retail sales at the standard rate of the EU member country in which the customer lives.<sup>107</sup> Every 3 months, the retailer is required to pay the VAT they have collected to the EU member country where they registered, along with an electronic form listing the sales and VAT collected for each EU member country.<sup>108</sup> The EU member country that the retailer is registered in then re-allocates the tax revenue to the appropriate countries.<sup>109</sup> The intent of this scheme is to streamline compliance and on-line reporting procedures.<sup>110</sup>

In comparison to the United States, there has been very little litigation over the applicability of VAT to internet sales in the European Union. One logical explanation for this is the US Constitution and the "substantial nexus" requirement.<sup>111</sup> The "substantial nexus" requirement set forth in *Quill* is the primary roadblock to tax collection on internet sales in the United States and the EU member countries do not face this type of roadblock.

## B. THE FOCUS ON SIMPLIFICATION

One of the most important aspects of the EU's system of taxing internet sales is the focus on simplicity and ease-of-use throughout its

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<sup>103</sup> *Id.*

<sup>104</sup> *Services Supplied Electronically*, *supra* note 84.

<sup>105</sup> Council Directive 2002/38, 2002 O.J. (L 128) (EC).

<sup>106</sup> *Services Supplied Electronically*, *supra* note 84.

<sup>107</sup> *Id.*

<sup>108</sup> *Id.*

<sup>109</sup> *Id.*

<sup>110</sup> *Id.*

<sup>111</sup> *See Quill Corp. v. North Dakota*, 504 U.S. 298, 301 (1992).

legislation.<sup>112</sup> As discussed above, the European Union made an attempt to simplify the reporting of VAT for non-EU retailers by implementing a scheme that allows a single place of registration for non-EU retailers and does not require the consumer to report VAT when it is a business-to-business sale.<sup>113</sup>

The EU's legislation has also kept things simple and efficient for EU member countries. One way they have done this is through the implementation of technology. First, VAT returns can now be submitted online.<sup>114</sup> Second, the EU created the VAT Information Exchange System ("VIES").<sup>115</sup> VIES is a network that can be used for real-time online confirmation of VAT status.<sup>116</sup> This can be used to determine whether the purchaser is a business or an individual consumer.<sup>117</sup> With this information the retailer will be able to determine first whether they have to collect VAT and second what rate should be applied.<sup>118</sup> When the EU was addressing the implementation of Council Directive 2002/38,<sup>119</sup> they also discussed the ability to verify the applicable rate on a customer through credit card billing addresses and geo-location tools.<sup>120</sup>

The EU's policy on goods sold at a distance has also helped to keep the collection of VAT simple for EU member nations.<sup>121</sup> A sale of goods at distance occurs when the purchaser and seller are located in different EU nations, and the goods are shipped to the purchaser.<sup>122</sup> When a good is sold at distance, the retailer applies the origin VAT rate as long as the consumer's annual purchases from the retailer do not exceed the threshold amount.<sup>123</sup> The threshold amount is relatively high and varies from EUR 35,000 to EUR 100,000 depending on the EU nation.<sup>124</sup> These

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<sup>112</sup> See Council Directive 2002/38, 2002 O.J. (L 128) (EC); *Services Supplied Electronically*, *supra* note 84.

<sup>113</sup> *Services Supplied Electronically*, *supra* note 84.

<sup>114</sup> See *Frequently Asked Questions*, EUROPEAN COMMISSION TAXATION AND CUSTOMS UNION, [http://ec.europa.eu/taxation\\_customs/taxation/vat/traders/e-commerce/article\\_1610\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/vat/traders/e-commerce/article_1610_en.htm) (last updated Jan. 31, 2013) [hereinafter *European Commission*].

<sup>115</sup> *Id.*

<sup>116</sup> *Id.*

<sup>117</sup> *Id.*

<sup>118</sup> See *id.*

<sup>119</sup> See Council Directive 2002/38, 2002 O.J. (L 128) (EC).

<sup>120</sup> See *European Commission*, *supra* note 114.

<sup>121</sup> See *Common System of VAT*, *supra* note 73.

<sup>122</sup> *Id.*

<sup>123</sup> *Id.*

<sup>124</sup> *Id.*

large threshold amounts simplify the process of collecting VAT for online retailers of goods by making the origin rate the applicable VAT rate on most sales to private individuals, as it would be uncommon for individuals to make online purchases that large from a single retailer.<sup>125</sup> This policy was not created specifically to address internet sales, as it was in place before the advent of such sales, but this legislation has become valuable to those retailers that now sell on the internet.

### **III. WHY THE UNITED STATES SHOULD LEARN FROM THE EUROPEAN UNION AND ADOPT A SIMILAR SYSTEM FOR TAXING INTERNET SALES**

#### **A. SIMILARITIES BETWEEN THE UNITED STATES AND EUROPEAN UNION SUGGEST MODIFICATION WOULD BE BENEFICIAL AND FEASIBLE**

The European Union modified its tax system to address new issues presented by the advent of internet sales that adversely impacted the fairness of its tax system.<sup>126</sup> The European Union felt that this modification was necessary to meet its overriding goal of promoting a single market and fair competition.<sup>127</sup> In the United States, the major concern with the internet sales loophole is that it creates an unfair advantage for internet retailers, the very same reason the European Union decided to modify their system.<sup>128</sup> The European Union felt it was necessary to adapt its tax system to the times, and the US should follow its lead as internet sales are not going to go away. This will continue to be a source of conflict until the United States addresses the issue.

Not only will the conflict remain, but it will also continue to grow. As the use of the internet for commerce continues to grow<sup>129</sup>, the conflict will continue to grow. This growth means that more and more in-state retailers with nexus will be adversely impacted and potentially be run out of business. Further, it will mean that increased amounts of state revenue from tax on internet sales will go uncollected<sup>130</sup> and adversely

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<sup>125</sup> *See id.*

<sup>126</sup> *See Services Supplied Electronically*, *supra* note 84; Council Directive 2002/38, 2002 O.J. (L 128) (EC).

<sup>127</sup> *Id.*

<sup>128</sup> *See MAZEROV*, *supra* note 25 at 3.

<sup>129</sup> *See BRUCE ET AL.*, *supra* note 1, at ii.

<sup>130</sup> *Id.*

impact state budgets that are already lacking revenue.<sup>131</sup> As a result, taxation of internet sales will continue to be a source of debate in the legislature as they look for ways to solve the revenue shortfalls.

### **B. COLLECTING TAX ON INTERNET SALES WOULD POSITIVELY IMPACT STATE GOVERNMENTS AND THE ECONOMY IN GENERAL**

The implementation of a system that effectively taxes internet sales could positively affect state governments by injecting their depleted budgets with additional revenue.<sup>132</sup> The projected \$11.4 billion dollars<sup>133</sup> of uncollected taxes on internet sales would help close the projected \$102.9 billion combined state deficit for the 2012 fiscal year.<sup>134</sup> States would be able to provide more services and help in the economic recovery if they were able to reduce deficits.<sup>135</sup>

A tax system that accounted for tax on all internet sales would not only increase state revenues, but would also help the states balance their budgets by allowing them to predict annual state revenue with greater certainty. Under the current tax system, states may struggle to predict future revenues from sales tax with any certainty. It is difficult to predict just how much internet sales will grow each year and how many of the internet sales to the state's residents will be from out-of-state retailers that are not currently required to collect sales tax because of the lack of nexus.<sup>136</sup> Forecasting annual revenues would be simplified if sales tax were collected on all online sales because the states would not have to anticipate how much sales tax will go uncollected due to internet sales. Increased simplification would in turn mean greater accuracy in predicting annual state revenues. The inability to predict how much internet sales will adversely impact state revenues hits some states harder than others. For instance, Tennessee relies on sales tax for 61.3% of its

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<sup>131</sup> See Combs, *supra* note 6 (listing the current state budget deficits on a state-by-state basis in regards to total amount of deficit and deficit as a percent of 2011 spending).

<sup>132</sup> See BRUCE ET AL., *supra* note 1, at ii.

<sup>133</sup> *Id.*

<sup>134</sup> Phil Oliff et al., *States Continue to Feel Recession's Impact*, CENTER ON BUDGET AND POLICY PRIORITIES (June 27, 2012), <http://www.cbpp.org/files/2-8-08sfp.pdf>.

<sup>135</sup> *Id.*

<sup>136</sup> See BRUCE ET AL., *supra* note 1, at ii (demonstrating how quickly the use of the internet has grown as a means of conducting commerce, and showing that the growth is expected to continue growing).



state tax revenues.<sup>137</sup> For a state that relies so heavily on revenue from sales tax,<sup>138</sup> an inability to accurately predict future sales tax revenue can adversely affect their ability to create a balanced budget for the upcoming fiscal year.

A system that collects tax on all internet sales could stimulate the economy through fairness in the retail market. Greater fairness in the tax code enhances the prospect of economic growth in several ways. First, it means that retailers with nexus, like local brick-and-mortar and click-and-mortar<sup>139</sup> retailers, will not be disadvantaged by the law when competing with internet retailers that lack nexus. With the elimination of the tax advantage, consumers will focus more on the products themselves and the pricing of the products. This is a more desirable tax policy as the tax does not directly affect the purchaser's economic decision when deciding between similar products.<sup>140</sup> This in turn means that the retailers will look to methods traditionally used to increase profitability like product improvements, pricing, and marketing to gain an advantage over their competition rather than relying on an advantage that comes from the tax code.

If the retailers are focused on providing a better product, they will invest in ways to improve the products they manufacture. Alternatively, if they purchase the goods from a manufacturer, they will demand that the manufacturer improve the product. These types of investments often entail expenditures on research and development and investments in new machinery for manufacturing the products. These potential expenditures create the prospect of new research and development jobs and increased sales and jobs for the producers of manufacturing equipment.

Another way that retailers could attempt to gain an advantage in a leveled playing field is through attempting to achieve economies of scale.<sup>141</sup> This strategy would also tend to create jobs as reaching

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<sup>137</sup> YOUNGER ASSOCIATES, THE IMPACT OF SALES TAX LOSS TO E-COMMERCE IN THE STATE OF TENNESSEE (2011), available at <http://standwithmainstreet.com/content.aspx?page=issuersources> (follow "Impact of Sales Tax Loss to E-Commerce in Tennessee" hyperlink).

<sup>138</sup> *Id.*

<sup>139</sup> See sources cited *supra* notes 38–40.

<sup>140</sup> See GRAETZ, *supra* note 7, at 10–11.

<sup>141</sup> See John Arndt & Leif Olsen, *A Research Note on Economies of Scale in Retailing*, 77 SWED. J. ECON. 207, 207. (1975) (explaining that an economy of scale refers to the fact that average unit costs decrease with increased volume).

economies of scale requires increased production.<sup>142</sup> This could mean, among other things, new manufacturing jobs, shipping jobs, machine manufacturing jobs and retail jobs.

The introduction of a tax system that effectively accounts for internet sales could not only create jobs revolving around manufacturing and selling the products, but it also has the potential to create a new industry to deal with the new tax system. New software and databases would be essential in limiting the burden of collecting tax on all internet sales. As the European Union has proven,<sup>143</sup> the use of technology can be very helpful in the efficient collection of tax on internet sales, and developers will see this as a potential area of rapid growth in the US market. Job creation would not only result from initial development of the databases and software, but also from the need to maintain these databases and of the need to develop new software as the technology evolves.

While a tax system that effectively collects tax on internet sales holds the possibility of economic growth, the potential overall negative impact on the economy is limited. First, it has the potential to negatively affect some internet retailers because they would lose the advantage they received by selling products without charging sales tax. However, these lost sales would likely represent the consumer choosing to purchase the product locally rather than online. So, when you look at the economy as a whole, the lost sale for the internet retailer is offset by the additional sale for the local retailer. Additionally, large internet retailers would still be highly competitive in the retail industry as they benefit from the large consumer base provided by the internet. This large consumer base would allow them to run large operations and attempt to achieve economies of scale.<sup>144</sup> As for the smaller internet retailers, the burdens of collecting the tax would be minimal if the United States were to follow in the footsteps of the EU by focusing on simplification and providing support through the use of technology.

Similarly, a simplified sales tax system that effectively collects tax on internet sales should not have much, if any, negative impact on the tax services industry. First, sales tax is only a small area of a complicated tax code. A simplification of sales tax regulations would have little

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<sup>142</sup> *See id.*

<sup>143</sup> *See European Commission, supra* note 114.

<sup>144</sup> *See Arndt & Olsen, supra* note 141, at 207 (explaining that, by running large, highly efficient operations, retailers are able to price their products very competitively).

impact on tax practitioners since there are still many other larger, more complicated areas of the tax code for them to practice in. In fact, a simplified sales tax code could create more work for tax practitioners because internet retailers that rarely collected sales tax before may need assistance. Also, as discussed above, if the playing field is leveled, retailers may begin to look to research and development and other strategies which often entail many important tax considerations like research and development tax credits. A large tax service industry in the European Union demonstrates that a simplified system for taxing sales has little negative impact on tax practitioners. Three of the Big Four Accounting Firms; PricewaterhouseCoopers,<sup>145</sup> Ernst & Young,<sup>146</sup> and KPMG<sup>147</sup> are headquartered in the European Union.

#### **IV. THE UNITED STATES SHOULD ADOPT THE THREE FUNDAMENTAL FACTORS OF FAIRNESS, SIMPLICITY, AND COOPERATION FROM THE EU'S SYSTEM WHEN IMPLEMENTING THEIR OWN SYSTEM**

##### **A. FAIRNESS**

The United States should follow the European Union and focus on the fundamental factor of fairness when implementing a tax system that collects tax on all internet sales. By implementing a fair system, the United States would develop a more efficient tax system that limits its impact on consumer decision making.<sup>148</sup> As explained in preceding sections, a tax system that limits its effect on economic decision making can have a far reaching positive effect on the economy as a whole.<sup>149</sup>

The EU's collection of VAT on internet sales presents an ideal model because not only does it allow EU member countries to collect the VAT they were owed to increase their revenues, but it also fairly affected

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<sup>145</sup> PricewaterhouseCoopers is headquartered in the United Kingdom. *About Us – PwC Worldwide*, PwC, <http://www.pwc.com/cl/en/quienes-somos/pwc-worldwide.jhtml> (last visited Jan. 18, 2012).

<sup>146</sup> Ernst & Young is headquartered in the United Kingdom. *Ernst & Young at a Glance*, ERNST & YOUNG, <http://www.ey.com/US/en/Newsroom/Facts-and-figures> (last visited Jan. 18, 2012).

<sup>147</sup> KPMG is headquartered in the Netherlands. *Big Four Accounting Firms*, BIG4ACCOUNTINGFIRMS.ORG, <http://www.big4accountingfirms.org/big-four-accounting-firms> (last visited Jan. 18, 2012).

<sup>148</sup> See GRAETZ, *supra* note 7, at 11.

<sup>149</sup> See *supra* Part III.B.

all those subject to the new rules.<sup>150</sup> The EU's system only levels the playing field between retailers and does not tilt the playing field the other way.<sup>151</sup> The European Union was careful not to implement a system that would be difficult to comply with and essentially disadvantage the internet retailers.<sup>152</sup> This is evidenced by the focus on simplicity, which is another focus area that the United States should adopt from the EU as I will discuss later, and the assistance they offered retailers in the member states through the use of technology.<sup>153</sup>

The United States should also follow in the EU's footsteps in allowing individual states to maintain a substantial amount of control over sales tax. In the European Union, the Council simply determined how the VAT would be collected and distributed on internet purchases.<sup>154</sup> The Council did not take control of all aspects of the system and still allowed member countries to set their own VAT rates<sup>155</sup> so long as they fell within existing limitations.<sup>156</sup> Allowing member countries this type of freedom limits any one member country from claiming it is disadvantaged by the legislation as all countries are still allowed substantial control over the economic decisions relating to the VAT they charge.<sup>157</sup> It would be important for the US government to treat the states fairly and allow them to retain as much power as possible if they were to implement a new system because federalism is an important part of the US Constitution. As I will discuss later, allowing states to maintain this kind of power may cause problems when dealing with states that currently do not have a sales tax.<sup>158</sup>

Retailers and consumers may be more willing to accept a system that collects tax on internet sales if the United States makes fairness the primary focus rather than state revenues. This is what the European Union did,<sup>159</sup> and it tends to put the focus on an inequality facing many retailers that needed to be addressed, rather than being a way to collect

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<sup>150</sup> See *Common System of VAT*, *supra* note 73.

<sup>151</sup> See *id.*

<sup>152</sup> See *Services Supplied Electronically*, *supra* note 84.

<sup>153</sup> *Id.*

<sup>154</sup> *Id.*

<sup>155</sup> See *id.*

<sup>156</sup> See *Common System of VAT*, *supra* note 73.

<sup>157</sup> *Id.*

<sup>158</sup> Delaware, Alaska, Montana, New Hampshire and Oregon. Robert W. Wood, *You Can Still Escape Sales Tax Online*, FORBES (Nov. 24, 2012), <http://www.forbes.com/sites/robertwood/2012/11/24/you-can-still-escape-sales-tax-online/>.

<sup>159</sup> See *Common System of VAT*, *supra* note 73.

more taxes. A revised system would likely face stronger opposition if it were simply seen as a way to collect more taxes because many individuals in the United States have a very strong anti-tax sentiment.

The government may benefit from any existing favoritism towards local businesses if they focus on fairness rather than state revenue when implementing a new system. The European Union focused on how their member states were being disadvantaged by non-EU Member Countries selling services over the internet without having to collect VAT on the services when they implemented the revisions to their system.<sup>160</sup> A similar approach could be taken by state governments to show that the retailers and business owners in the state are being unfairly disadvantaged by the current system that allows certain out of state retailers to sell products to consumers in the state without having to collect sales tax, thus making their products more appealing.

### **B. SIMPLICITY**

Focusing on simplicity like the European Union did will make modifying the collection of tax on internet sales more feasible and effective. It will be easier for retailers making internet sales all over the country to comply if the tax code is simplified. Ease of compliance will be especially important when dealing with smaller retailers that cannot spend large amounts of money on complicated systems to track tax on internet sales. Additionally, simplifying of the sales tax system will not only benefit those directly affected by internet sales, but also all other retailers as it will cut down on administrative costs on all sales.

United States retailers can also seek simplification of the process through technology. Similar to what is done in the European Union,<sup>161</sup> the US retailers should rely on software and databases to simplify the process of collecting sales tax for the various states. As was done in the European Union, the US government should lead the way in developing the software and databases so that it can be made available to retailers of any size at no cost.<sup>162</sup> It would be a small price to pay for the potentially large increase in state revenues. It could also simplify the US government's collection of such taxes from retailers if they are all using the same software.

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<sup>160</sup> See *Services Supplied Electronically*, *supra* note 84.

<sup>161</sup> See *European Commission*, *supra* note 114.

<sup>162</sup> See *id.*

The groundwork is already in place for a movement towards the simplification of sales tax. The major focuses of the Streamlined Sales and Use Tax Agreement<sup>163</sup> are uniformity and simplicity.<sup>164</sup> The objective of the agreement is to substantially reduce the burden of complying with sales tax regulation.<sup>165</sup> With twenty-four states already signed onto the agreement,<sup>166</sup> the United States is almost halfway to creating a more simplified sales tax system.

### **C. THE STATE GOVERNMENTS HAVE TO COOPERATE AND MAKE CONCESSIONS LIKE THE EU MEMBER STATES**

The United States should be willing to compromise in order to successfully implement a tax system that collects tax on internet sale. The European Union did not simply demand that member countries begin collecting VAT on all internet sales but rather compromised with member countries to develop a simplified system.<sup>167</sup> For instance, the EU's system allows retailers to collect origin VAT on small purchases of goods rather than requiring them to collect destination VAT.<sup>168</sup> As a result of the combined efforts of both the European Union and its member countries, the member countries benefited from increased VAT revenues due to the collection of VAT on internet based services, and the European Union as a whole benefited from increased fairness for its retailers.<sup>169</sup>

The implementation of a tax system that effectively collects tax on internet sales would likely fail if the states do not make concessions to make the implementation of such a system more feasible. As discussed above, simplification is the biggest area where the United States will have to make concessions.<sup>170</sup> Simplification of the code and government assistance in the creation of software and databases would go a long ways in implementing such a system.

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<sup>163</sup> See *supra* Part I.B.

<sup>164</sup> See STREAMLINED, *supra* note 63.

<sup>165</sup> *Id.*

<sup>166</sup> *Id.*

<sup>167</sup> See *Services Supplied Electronically*, *supra* note 84.

<sup>168</sup> See *Common System of VAT*, *supra* note 73.

<sup>169</sup> See *id.*

<sup>170</sup> See *supra* Part IV.B.

#### D. LIMITATIONS ON THE UNITED STATES' ABILITY TO ADOPT SUCH A SYSTEM

There are three major issues currently affecting the United States' ability to modify the current tax system to address the issue of collecting tax on all internet sales. These issues are the variation in state tax laws, *Quill*,<sup>171</sup> and the current partisan divide in the legislature.

The variation in state tax laws leads to two distinct problems. First, there is the logistical complexity of charging the correct rates and keeping track of what tax is reported to what state.<sup>172</sup> This problem posed by complexity, however, can be greatly reduced by focusing on simplicity when modifying the system as discussed in the preceding sections. Additionally, the use of technology could be used to streamline and simplify the process as was discussed in the previous sections.<sup>173</sup> Second, there is the problem caused by the five states<sup>174</sup> that do not have sales tax and the resulting incentive to conduct business there that would result if the United States implemented a system to collect tax on all internet sales.<sup>175</sup> As long as those five states have no sales tax, the United States will not be able to adopt the EU's method of simplifying the collection of tax by charging the origin rate on services and goods (within the threshold) sold at a distance.<sup>176</sup> If the United States were to charge the origin rate on those types of sales, retailers would relocate to states with no sales tax so they could sell their product for less and gain a competitive advantage over competition. This would effectively lead to the same type of unfairness that currently exists between "brick" retailers and internet retailers, only the advantage would be limited to internet retailers based in states that don't have sales tax.<sup>177</sup>

The issue of federalism further complicates the problems created by some states having no sales tax. In the United States, sales tax rates and administration of the tax has always been left to the states themselves, not to the federal government. For this reason, there is little that can be done to get those states with zero sales tax to assist in a

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<sup>171</sup> Morris, *supra* note 53, at 292.

<sup>172</sup> See EISENACH & LITAN, *supra* note 18, at 12–13.

<sup>173</sup> See *supra* Part IV.B.

<sup>174</sup> Delaware, Alaska, Montana, New Hampshire and Oregon. Wood, *supra* note 158.

<sup>175</sup> CORPORATE COUNSEL'S GUIDE, *supra* note 19, § 6.27.

<sup>176</sup> See *Common System of VAT*, *supra* note 73.

<sup>177</sup> Giving certain internet retailers a competitive advantage based solely on how sales tax applies to them; and influencing corporate decision making, and more specifically where the corporation locates itself.

movement to collect tax on internet sales. There is very little incentive, if any incentive at all, for the states with no sales tax to assist in the effort to collect tax on internet sales as they would not gain any revenue directly from it. In fact, there is the possibility that they could increase revenues by not complying if a system for collecting tax on internet sales were adopted that used origin tax rates to simplify the process. If this were the case, internet retailers would be tempted to move their distribution centers and headquarters to those states to be able to sell products and services tax free. Looking to the European Union is of little help on this point as they have minimum VAT requirements for the member countries set by the European Union.<sup>178</sup> The United States does not have the option to simply set a minimum sales tax percentage to help alleviate the problem.

*Quill* imposes the problem of “substantial nexus.”<sup>179</sup> *Quill* is one of the first cases, if not the first case, cited in litigation on the topic of collecting tax on internet sales.<sup>180</sup> The United States Supreme Court has not directly ruled on the constitutionality of any “Amazon laws” yet, but *Quill* would likely be a key case if this type of legislation was reviewed by the United States Supreme Court. The effect that *Quill* has had on individual states attempting to collect tax on internet sales is clear from case law,<sup>181</sup> but it is also likely to have a large impact on the federal government’s ability to implement legislation on the topic. It is almost certain that large internet retailers will challenge the constitutionality of the legislation and rely heavily on *Quill*. For this reason, *Quill* will likely have to be overruled, or the legislature will have to somehow find a way around the “substantial nexus” requirement of *Quill*.

In the current United States political climate, increased partisanship at the legislative level has become an issue whenever attempting to pass legislation at both the federal and state levels. While this may be a realistic fear, the facts suggest that this actually will not be that large of a hurdle to overcome. Both Republicans and Democrats have supported “Amazon tax” legislation.<sup>182</sup> For example, the Marketplace Fairness Act was introduced on November 9 by Senators Dick Durbin (D-IL), Mike Enzi (R-WY), and Lamar Alexander (R-

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<sup>178</sup> See *Common System of VAT*, *supra* note 73.

<sup>179</sup> *Quill Corp. v. North Dakota*, 504 U.S. 298, 313 (1992).

<sup>180</sup> See, e.g., *St. Tammany Parish Tax Collector v. Barnesandnoble.com*, 481 F. Supp. 2d 575 (E.D. La. 2007).

<sup>181</sup> *Id.*

<sup>182</sup> See Marketplace Fairness Act, S. 1832, 112th Cong. (2011).



TN).<sup>183</sup> The legislation enjoys bipartisan support with five Republicans and five Democrats as original cosponsors.<sup>184</sup> This could be seen as sign that the Republicans and Democrats will put their differences aside to fix the loophole.

### CONCLUSION

State governments are losing out on billions of dollars that go uncollected on internet sales each year due to a tax system that is not compatible with modern day internet commerce. The United States should look to close this tax loophole as state budget shortcomings are always a present concern and there is constant debate over the unfair advantage that internet retailers have over traditional retailers.

The United States should look to the European Union for guidance in implementing such a system. Although differences between the two tax systems make it impossible for the United States to adopt the exact system used by the European Union, it is a good place to start. The European Union addressed the problems that modern day e-commerce caused its VAT system by focusing on the basic principles of fairness, simplicity, and cooperation. A fair compromise between states, retailers, and consumers in the United States could possibly be achieved by focusing on these three principles when designing and implementing a new system to collect tax on internet sales in the United States.

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<sup>183</sup> *Id.*

<sup>184</sup> *See id.*