Current Developing Trend of Sales Tax on E-Business

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ABSTRACT

This article explores the development of sales tax on e-business. It points out that the problem was rooted in the fact that the seller is required to collect and remit the tax to the buyer’s state government. If the seller and the buyer do not reside in the same state, the buyer’s state government has no jurisdiction over the seller, unless there is a “physical presence” of the seller in the buyer’s state. A state government can require an out-of-state seller to collect sales tax from the in-state buyer only when there is “physical presence.” However, what constitutes “physical presence” can become very controversial and complex. This article discusses many court cases. As Internet commerce was incorporated into the business operations, a great many transactions were executed online. The concept of “physical presence” became even more complex, as websites and digitized products became more commonplace. A new concept of “economic nexus” has evolved under many state statutes. Now an out-of-state seller may be required to collect sales tax from an in-state buyer, regardless of “physical presence.” In 2013 the United States Senate enacted the “Marketplace Fairness Act of 2013.” This embraced the concept of “economic nexus.” This legislation could potentially end or at least greatly simplify all controversies in e-business taxation. This paper further notes that the concept of “economic nexus” may be extended to the arena of state income tax.

Keywords: Amazon Tax, E-Business, Economic Nexus, Marketplace Fairness Act of 2013, Physical Presence, Sales Tax, Streamlined Sales, Use Tax Agreement

INTRODUCTION

The volume of e-business sales is expected to grow from $259 billion in 2013 to $297 billion in 2014 with a growth rate of 15.7% per year and accounts for 6.4 percent of the total retail sales (The United States Department of Commerce, 2014). The sheer numbers are astounding and the trend is accelerating. Unfortunately, there is a growing tax problem related to this development. E-business entails sales tax just like any other business transactions. Sales tax has traditionally belonged to the jurisdiction of the state and local governments, but most of the online sellers reside outside of the state boundary of the purchaser. This makes it very...
difficult to collect sales tax from them. By recent estimate the sales tax revenue lost is $23 billion a year (Langley, 2012). The situation is becoming more serious recently only because of the tremendous growth of e-business volume. Where is the problem? The solution is extremely tumultuous. What is the current status now? The controversies involve the concepts of “physical presence” versus “economic nexus.” It is further complicated by the legal aspects of the “Streamlined Sales and Use Tax Agreement” and the “Marketplace Fairness Act of 2013.” This article investigates the evolution of sales tax in e-business and points to the trend of future development.

PROBLEMS OF SALES TAX IN INTERSTATE COMMERCE

The Commerce Clause of the Constitution of the United States granted sales tax to the state government to finance its operations, but it did not define a state’s authority in collecting the tax (The United State Constitution.) Then the interstate commerce thrived. The sales tax immediately involved out-of-state sellers. Can the state government have the authority to collect sales tax from the sellers outside of the state of the purchaser? A problem is raised.

The Fourteenth Amendment in 1868 imposes a limit. It provides that “No State shall make or enforce any law which shall abridge the privilege or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws” (The United States Constitution Fourteenth Amendment).

The Amendment clearly prohibits the state government to collect sales tax from the sellers residing outside of the state boundary, unless there is a “due process” between a seller and the state. What is the “due process?” This is another problem.

“PHYSICAL PRESENCE” TO PAY SALES TAX

The “due process” has been interpreted to require a “nexus” or connection between the seller and the state. In other words, the seller has received government service from the state. In a sales transaction, if the buyer and the seller reside in the same state, it is the seller’s responsibility to collect sales tax from the buyer and remit it to the buyer’s state government, because there is a connection between the seller and the state. Thus, the minimum connection of the Due Process Clause and the substantial nexus of the Commerce Clause are clearly satisfied.

If the buyer and the seller do not reside in the same state it is the buyer’s duty to remit the amount of sales tax to his/her own state government. This is known as “use tax.” In this situation, the seller is not held responsible for collecting sales tax from the buyer, because there is no “nexus” or connection between the seller and the state. Hence, the “due process” is not satisfied.

For example, Susan, a New Jersey resident, is a garden lover. She bought flower seeds from the local Plouch Garden Center in New Jersey. She also bought vegetable seeds from Gardener Supply in Maine. How should Susan pay sales tax? Plouch should collect sales tax from Susan because Plouch has “physical presence” in New Jersey. However, Gardener Supply is not required to collect sales tax from Susan because Gardener Supply has no “physical presence” in New Jersey. Instead, Susan should voluntarily remit the due amount of “use tax” to her home state of New Jersey.

At the time the Commerce Clause was drafted the intent was to prevent the states from interfering with interstate commerce. It was easy to identify the location of the buyer and the seller, and if both resided in the same taxing jurisdiction there was no need for regulation by Congress. The interpretation requiring physical presence when buyer and seller were not in the same state made sense.
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