The Principle of Nexus in E-Commerce Tax

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James G. S. Yang
Montclair State University, USA

INTRODUCTION

According to the most recent report from the U. S. Department of Commerce, the amount of e-commerce has been increasing rapidly from a meager $35 billion in 2001 to a whopping $225 billion in 2012. It accounts for as little as 1.1% of the total retail sales in 2001 to as much as 5.2% in 2012. Its growth rate maintains steadily at an incredible 19.3% a year on the average in the past ten years. During this short period of time the e-commerce has grown from its infancy to its maturity. The annual data are shown in Table 1 (U.S. Department of Commerce, 2013).

The growing trend above is truly astonishing and awesome. In fact, e-commerce has become the driving engine in today's economic development. However, there is a growing problem. E-commerce gives rise to sales tax which belongs to the jurisdiction of the state and local governments. If the seller and the buyer reside in the same state, the seller is legally required to collect sales tax from the buyer and remit it to the buyer's state government. Nevertheless, if the seller and the buyer reside in two different states, the seller is not responsible for collecting the sales tax. Instead, it is the buyer's duty to pay use tax to his/her own state government. Unfortunately, a great majority of the buyers simply ignore their tax-paying duties. Most of the e-commerce transactions cross the state border, especially in today's online business. As a consequence, the state governments are unable to collect sales tax from e-commerce. The lost sales tax amounts to as much as $8.6 billion in 2010 (Campoy, 2011).

Table 1. Growth of E-Commerce

	Amount (in Billions)	As a Percent of Total Retail Sales	Annual Growth Rate
2012	$225	5.2%	16.6%
2011	$193	4.6%	16.9%
2010	$165	4.2%	14.6%
2009	$144	3.4%	1.4%
2008	$142	3.6%	3.7%
2007	$137	3.4%	20.2%
2006	$114	3.0%	20.4%
2005	$92	2.5%	24.3%
2004	$74	2.1%	25.6%
2003	$58	1.8%	28.9%
2002	$45	1.5%	28.6%
2001	$35	1.1%	25.0%

Source: The United States Department of Commerce, Census Bureau, E-Commerce Survey, February 15, 2013.

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RESEARCH QUESTIONS

In view of these new developments in Internet commerce taxation it would be interesting to investigate the following questions. What is the legal basis for sales tax jurisdiction? What are the requirements for a state government to impose sales tax collecting duties on an out-of-state seller? What is the court decision concerning sales tax on mail-order transaction, cross-border purchase, independent contractor, traveling salesmen, and computer software, respectively? What is "New York's Amazon tax law?" What constitutes "nexus?" What is the difference between "physical presence" and "economic presence?" What is Jenkins Act? What is the current status of Internet commerce taxation? What is the possible direction of development in e-business taxation in the future? These questions involve statutes and court rulings. They belong to the realm of legal aspects and require legal research.

TAX PROBLEM ARISING FROM E-COMMERCE: INTERSTATE COMMERCE

Income tax is based on the income earned; whereas, sales tax depends on the income spent. The former belongs to the federal and the state governments; nevertheless, the latter is exclusively given to the state and local governments according to the Commerce Clause of the Constitution of the United States (Constitution of the United States, Article 1, Section 8, Clause 3). There are fifty different states plus District of Columbia. A sales transaction may cross the state border. This is known as "interstate commerce." Each state may have different sales tax law. In order to protect a state's own business interest, a state may enact a law that discriminates against the business from other states. This will jeopardize the free flow of commerce. This is not in the best of the entire nation as a whole.

In order to remedy these possible deficiencies and problems of interstate commerce the Fourteenth Amendment to the Constitution of the United States 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" (Fourteenth Amendment to the Constitution of the United States, Article 1, Section 8, Clause 3).

PROBLEM WITH SALES TAX COLLECTION

When an employee earns wage, no matter whether it is earned within or without the state, the employer is required to withhold income tax from the employee. Conversely, when a buyer spends the income within or without the state, is the seller required to collect sales tax from the buyer? It depends on where they reside. If they reside in the same state, it falls onto the seller's duty. If they don't, it is the buyer's responsibility. This is known as "use tax." However, if the buyer ignores his/her tax-paying duty, can the state government impose such a duty on the seller? The seller may invoke the protection of "due process of law" and the "equal protection of the laws" under the Fourteenth Amendment, as mentioned above.

Even if an out-of-state seller is legally required to collect sales tax from the buyer, there is an administrative nightmare. There are 30,000 jurisdictions in the nation (Griffin, Ladd, & Whitehead, 1998). Each jurisdiction has different sales tax rate and different list of taxable and nontaxable items. It is almost impossible to figure out the sales tax amount and remit it to so many government agencies. In today's e-commerce, transactions reach every corner of the nation. It makes the sales tax collection problem even worse.

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