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Current Developing Trend of Sales Tax on E-Business

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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).

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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.

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.

Now, time and circumstances have changed. Today, many products can be digitized, such as software, e-books, e-games, e-music, etc. The product can be transferred from one computer to the other without knowing where the seller resides. Likewise, it may be difficult if not impossible to identify where the buyer resides. The concept of "physical presence" has encountered many problems in today's Internet age. Here are some of the issues.

Physical Presence of a Website

All digitized products can be purchased and sold on a website. What is the state residency of a website? For example, John designs a tennis-playing game and puts it on the website of http://www.yahoo.com/game for game lovers to play for a fee. Anyone who plays it pays $5 by credit card. Tom plays it and pays for it by using his Citibank credit card. Where does John reside? Likewise, where does Tom reside? It is probably impossible to know for certain. Without knowing whether John resides in the same state as does Tom, how can Tom decide whether he should pay sales tax to John directly or remit the "use tax" to his own state government? If John resides in a state other than Tom's state, Tom can legally refuse to pay sales tax to John directly. Reciprocally, John also can refuse to collect sales tax from Tom. If Tom ignores his use tax-paying responsibility, Tom's state government stands to lose the use tax revenue.. At a time when many state governments are strapped for cash and some face huge underfunded pension liabilities the loss of potential revenue is a major concern,

John's website is not registered in any state. It has no "physical presence" in any state. It exists only on the Internet. A website is not a person, but it acts like a seller. So, what is the state residency of a website? Can a website be construed as the state of residency of the seller? The situation becomes quite confusing. It shows that the existing physical presence concept now breaks down, because it is obsolete and out-of-date in a transaction on the website. Evidently, there is another problem.

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