



Examining Wisconsin's Progress in Leveling the Tax System for Retailers

Wisconsin's sales tax is a significant source of state revenue. In FY 2008-09, the sales tax raised \$4.1 billion for state services.¹ Sales tax is due on most purchases made in Wisconsin, whether they are made at a neighborhood store or from an online retailer. However, a loophole in federal law means that some online retailers are required to collect sales tax due while others are not.² Estimates of the revenue loss from this loophole exceed \$100 million in Wisconsin alone in FY 2009-10.³

The rapid growth in internet commerce makes the sales tax loophole an increasing problem for "Main Street" retailers and for state budgets. It is one of many commercial and demographic trends that prevent our state's revenue system from growing in step with the economy.

In Act 2 of 2009, the Legislature took a modest but important step by adopting the Main Street Equity Act. That new law encourages retailers to collect taxes on online sales by creating far more consistency between states, but it does not plug the current loophole. Unfortunately, at this point there are no easy solutions at the state level for capturing all the lost sales tax revenue, although several states have tried a variety of methods.

The Sales Tax

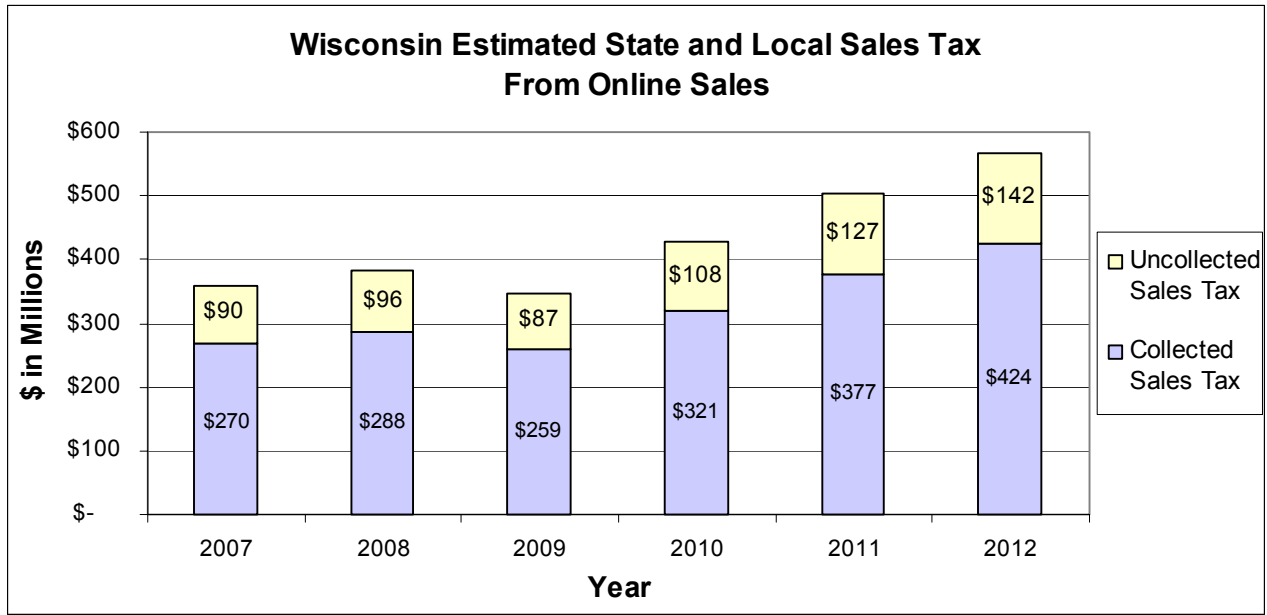
Wisconsin imposes a 5% general sales tax on the sale and rental of property and selected services; counties have the option of imposing an additional 0.5% local sales tax.⁴ Revenue from sales taxes comprise a third of the General Fund, the second largest revenue source for the General Fund after the individual income tax.⁵

The sales tax is collected from the buyer by the seller, who remits the tax to the Wisconsin Department of Revenue. Most goods are subject to the sales tax, with certain specific exemptions such as food for home consumption. Goods and services purchased by Wisconsin residents over the internet are subject to the Wisconsin sales tax in much the same manner that they would be if they were purchased from a bricks and mortar business.⁶ However, some online retailers have structured their corporations in a way to thwart the collection of sales tax on their products.

Different Rules for Different Retailers

Here's how it works:

- Retailers that are based in Wisconsin or have a Wisconsin presence and that sell online to Wisconsin residents are required to collect and remit the sales tax the same as bricks and mortar retailers.
- Out-of-state retailers without a presence in Wisconsin who sell online to Wisconsin residents are not required to collect sales tax; instead, buyers are required to individually report purchases and tax due as part of their individual income tax filings. For example, Amazon.com does not collect Wisconsin sales tax; sales tax is still due on their sales in Wisconsin, but it is up to the purchaser to pay it individually. It simply is not cost-effective to collect this revenue from individual households instead of from sellers, and thus this revenue goes largely uncollected. This different tax structure results in millions of dollars of lost revenue annually.⁷



Source: *State and Local Government Sales Tax Revenue Losses from Electronic Commerce*. University of Tennessee.

Why the differing treatment? In a 1992 ruling, the United States Supreme Court established that retailers are exempt from collecting sales taxes in states where they have no business connection, such as a store, office, or warehouse. The legal term for this connection is “nexus.”⁸

Some online-only retailers such as Amazon.com use a legal technicality to structure their corporation in a way that avoids having nexus, even in states where they have a presence. Amazon’s annual report lists Wisconsin as among the states in which Amazon has facilities,⁹ yet Amazon has structured its corporation in a way to maximize its ability to make sales without collecting sales tax. Amazon and some other online-only retailers break up their corporations by placing pieces of the business in individual subsidiaries that do not sell directly to the customer, and then contend that they do not have nexus and are not required to collect sales tax.¹⁰

A 2009 University of Tennessee study estimated that in FY 2009-10, \$428 million in state and local sales tax will be due in Wisconsin on online sales. Twenty-five

percent of that amount, or \$108 million, is estimated to be uncollected.¹¹

Regardless of whether they have nexus in the state, online retailers benefit from state services just as bricks and mortar business do. States maintain the roads that enable delivery of their goods, and provide public services that help protect the goods in transit. Online-only retailers that do not collect sales tax currently enjoy a competitive advantage over local Wisconsin businesses, since they offer a five percent price break in the form of uncollected sales tax.

In its ruling, the Supreme Court noted that Congress could enact legislation requiring all retailers to collect sales taxes regardless of nexus. Online retailers have resisted action by Congress, citing the high cost of complying with many different tax systems across the country.¹² Since Congress has not taken action on this issue, states have increasingly come to take action on their own. Efforts include the Streamlined Sales and Use Tax Agreement and New York’s “Amazon Law.”

Encouraging Voluntary Compliance: The Streamlined Sales and Use Tax Agreement

In an effort to make it as easy as possible for online retailers to collect sales tax, states have

worked together to create the Streamlined Sales and Use Tax Agreement (SSUTA), which seeks to decrease tax compliance costs and to encourage retailers to voluntarily collect sales tax in states in which they do not have nexus. Twenty-three states have adopted the standard definitions and procedures specified in the agreement.¹³ Wisconsin adopted the definitions and procedures in the 2009 budget adjustment bill (Act 2), in provisions known as the Main Street Equity Act. The changes became effective on October 1, 2009.¹⁴

According to the WI Department of Revenue, the changes enacted as part of joining SSUTA will increase overall revenues by \$2 million in FY 2009-10 and \$2.7 million in FY 2010-11. Although the modifications in product definitions will result in a decrease in sales tax revenue, it is estimated that the decrease will be more than offset by an increase in voluntary sales tax collections. As part of participation in SSUTA, Wisconsin offers a tax amnesty period for retailers without nexus who voluntarily begin to collect sales tax having not previously done so.¹⁵ According to the Streamlined Sales Tax Governing Board, 1,200 retailers without nexus are collecting sales tax voluntarily in states that have ratified SSUTA.¹⁶ This is a start, although it is a small percentage of the sales tax that remains uncollected.

Wisconsin Could Follow Other States' Examples in Attempting to Compel Sales Tax Collection¹⁷

Seeking greater ability to compel online-only retailers to collect sales tax due, New York enacted a law in 2008 that considers a retailer to have nexus in the state if it has independent "affiliate" websites in the state promoting sales on its behalf. Many large on-line only retailers operate on this model; although Amazon does not reveal the number of affiliate websites it has, it is believed to be at least hundreds of thousands. This law is commonly referred to as the "Amazon law," after the largest retailer that would be affected. Since then, Rhode Island and North Carolina¹⁸ have enacted similar laws.

Many online-only retailers have in-state affiliates that place links to the retailer's website and then receive a commission when a sale is made. The legislation enacted by New York and other states defines this relationship as satisfying the condition for nexus in the state. It is not a perfect solution: not all online retailers use the affiliate model, and retailers may drop affiliates in a particular state in an effort to avoid collecting sales tax, as Amazon has in Rhode Island and North Carolina.¹⁹ Still, New York estimates the change will result in an approximately \$33 million increase in collection of state sales tax in 2010, and about the same amount in local sales tax. The legislation, challenged by Amazon, has been upheld in January 2009 and is now before a New York appeals court, which is expected to issue its decision in the first part of 2010.²⁰

In February 2010, Colorado took a different approach in an attempt to encourage collection of online sales tax. Colorado now requires online retailers who do not collect Colorado sales tax to tell customers that they still owe the tax, and to notify the state annually of the dollar amount of purchase made by Colorado customers. In response, Amazon dropped all Colorado affiliates, even though there is no connection between the affiliate program and the new law.

Conclusion

There are many economic and demographic trends that create growing problems for state and local budgeting. Among those is the sharp increase in online commerce. Although state sales taxes apply to most goods, regardless of how they are sold, federal law severely limits states' capacity to collect the tax on sales made online by uncooperative retailers, unless they have a presence in the state. And some retailers who do have a physical tie are able to evade the tax by creating subsidiaries that separate the portion of the corporation that makes the sale from the portions that have a presence in the state.

Exempting large online retailers from collection of sales taxes erodes a key source of

state and county revenue. It also gives those retailers a significant competitive advantage over the bricks and mortar businesses in our communities. Wisconsin took a small but important step toward addressing the problem by enacting the Main Street Equity Act. Those provisions make sales tax definitions consistent among the participating states, which encourages cooperative retailers to voluntarily collect taxes on online sales.

Like New York and other states, Wisconsin could adopt affiliate legislation in an attempt

to compel Amazon and other similar retailers to collect sales tax. However, it's not clear if this approach would result in additional sales tax collections, as Amazon would be likely to drop its affiliates in Wisconsin. The issue of online sales tax could be easily addressed at the federal level, but is more challenging to address at the state level.

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¹ State of Wisconsin. (2009). *Annual Fiscal Report*.

² Wisconsin Legislative Fiscal Bureau. (2009, January). *Sales and Use Tax, Informational Paper 6*.

³ Bruce, D., Fox, W., & Luna, L. (2009, April). *State and Local Government Sales Tax Revenue Losses from Electronic Commerce*. University of Tennessee.

⁴ *Sales and Use Tax, Informational Paper 6*.

⁵ *Annual Fiscal Report*.

⁶ *Sales and Use Tax, Informational Paper 6*.

⁷ *Sales and Use Tax, Informational Paper 6*.

⁸ *Internet Sales Tax Fairness*. A Program of the Institute for Local Self-Reliance. www.newrules.org

⁹ Amazon.com 2008 Annual Report

¹⁰ Mazerov, M. (November, 2009). *Amazon's Arguments Against Collecting Sales Taxes Do Not Withstand Scrutiny*. Center on Budget and Policy Priorities.

¹¹ *State and Local Government Sales Tax Revenue Losses from Electronic Commerce*

¹² *Internet Sales Tax Fairness*.

¹³ Streamlinedsalestax.org.

¹⁴ Streamlinedsalestax.org.

¹⁵ Wisconsin Legislative Fiscal Bureau. (Feb 2009). *Summary of Budget Adjustment Provisions*.

¹⁶ Streamlinedsalestax.org.

¹⁷ Unless otherwise noted, information in this section is from Mazerov, M. (July, 2009). *New York's "Amazon Law": An Important Tool For Collecting Taxes Owed On Internet Purchases*.

¹⁸ Fowler, J. (June 30, 2009). Amazon Drops More Affiliates To Avoid Tax. *The Wall Street Journal*.

¹⁹ Amazon Drops More Affiliates To Avoid Tax

²⁰ Lemov, P. (December 16, 2009). The 'Amazon Tax': Friend or Foe? *Governing*.