What if Arizona charged sales tax on retail Internet sales?

Arizona might have millions more in its coffers if it could better tap the thousands of electronic transactions between buyers and sellers. With the sales tax Arizona's most important revenue source and U.S. online retail expected to grow to $335 billion in 2012[1], getting a greater return on "click to shop" is more attractive than ever. A recent University of Tennessee study estimated that state and local governments nationally did not receive $7.2 billion in sales tax revenues in 2007 from online transactions. The figure is predicted to rise to $11.4 billion in by 2012. Arizona's share was estimated at $235.2 million and $369.8 million respectively.[2] But a combination of local, state, and federal changes will be needed to reap all of benefits possible.

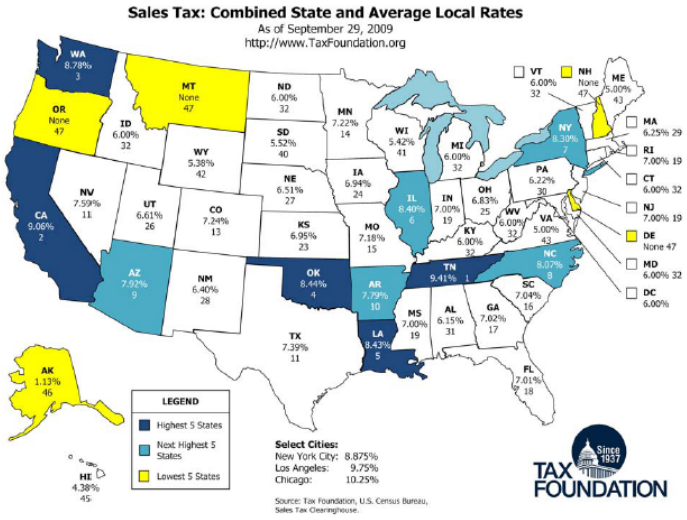
Total State and Local Sales and Use Tax Revenue Losses from E-Commerce Sales ($millions), Arizona and Selected States, 2009

	$ 2007	$ 2008	$ 2009	$ 2010	$ 2011	$ 2012	Six-Year Total
Arizona	**235.2**	**250.8**	**225.6**	**279.8**	**329.0**	**369.8**	**1,690.3**
California	1,211.2	1,291.6	1,162.1	1,441.1	1,694.4	1,904.5	8,704.8
Colorado	109.9	117.1	105.4	130.7	153.7	172.7	789.5
Idaho	29.5	31.4	28.3	35.1	41.2	46.4	211.9
New Mexico	76.6	81.7	73.5	91.1	107.2	120.5	550.5
Texas	553.6	590.3	531.1	658.6	774.4	870.4	3,978.3
Utah	56.3	60.0	54.0	66.9	78.7	88.5	404.3
Washington	179.3	191.2	172.0	213.3	250.8	281.9	1,288.7
U.S. TOTAL	7,245.6	7,726.3	6,951.4	8,620.4	10,135.8	11,392.7	52,072.2

Source: State and Local Government Sales Tax Revenue Losses from Electronic Commerce University of Tennessee, April 2009.

As enticing as the revenue is, capturing it is difficult. Two Supreme Court[3] rulings, both pre-Internet and the last in 1992, noted that until Congress acts, states cannot require sellers to collect and remit sales tax unless the seller has a physical presence, known as nexus, in the state. In other words without a real store, "taxation of out-of-state remote sales is currently prohibited by law as unduly burdensome to interstate commerce."[4]

Thus, Arizona's current transaction privilege (commonly referred to as sales tax since the business passes it on to consumers) and use tax policies address online sales in a limited way only.[5] The transaction privilege tax is a general sales tax in which the seller is responsible for remitting the tax.[6] Businesses collect taxes for online purchases when a business that may be headquartered out of state has a store in Arizona. In turn, a use tax is a sales tax imposed on goods purchased outside a state for which state sales tax has not been paid.[7] Internet purchases from a vendor without nexus

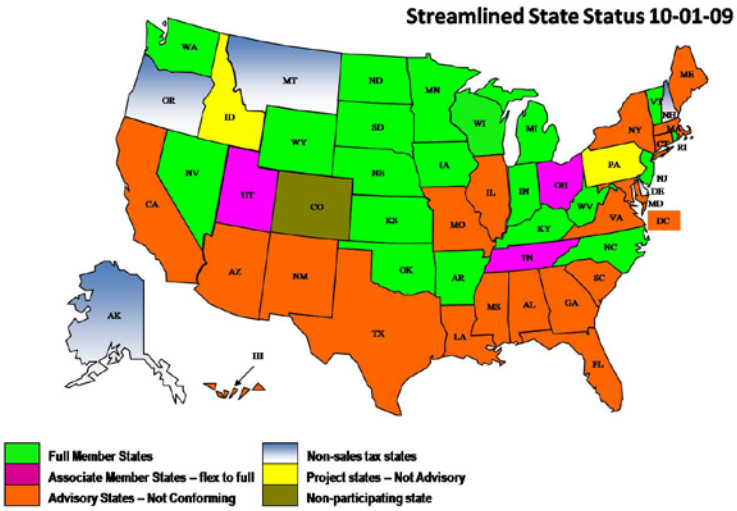


[1] According to Forrester Research,
[2] Bruce, Donald, J., William F. Fox, William B. Stokely, LeAnn Luna, State and Local Government Revenue Losses from Electronic Commerce, University of Tennessee, April 13, 2009.
[3] *National Bellas Hess v. Illinois (1967) and Quill Corp. v. North Dakota (1992)*
[4] Internet and Remote Sales Tax Collection: The Application of the Streamlined Sales Tax Statute in Arizona, Transaction Privilege Tax Research Committee, Citizens Finance Review Commission, August, 29, 2003.
[5] Joint Legislative Budget Committee's 2009 Tax Handbook
[6] Riding the Fiscal Roller Coaster: Government Revenue in Arizona, Appendix 3, Glossary, W. P. Carey School of Business, Arizona State University, 95th Arizona Town Hall, November 2009.
[7] Riding the Fiscal Roller Coaster: Government Revenue in Arizona, Appendix 3, Glossary, W. P. Carey School of Business, Arizona State University, *95th Arizona Town Hall*, November 2009.

in Arizona are subject to use tax, but it is rarely paid. Thus, online shopping is often viewed as "tax free." Arizona and local governments miss revenue, and bricks and mortar businesses experience more competition.

Congress has yet to act to authorize states to collect from online retailers, although federal legislation has been introduced repeatedly. Now some observers give the *Main Street Fairness Act*, which is expected to be introduced soon in the U.S. House, a better chance of passage.[8] This federal legislation would provide the guidance every state needs on definitions and collection mechanisms.

As the Internet and e-commerce was gaining steam early in the 2000s, states developed the Streamlined Sales Tax Project to simplify and modernize sales and use tax collection and administration to ease the burden on businesses and try to convince Congress allow states to tax remote sales.[9] States opt in to the Streamlined Sales and Use Tax Agreement (SSTA) and change their policies to conform. The agreement is intended to simplify and harmonize tax administration for everyone. For example, the pact sets up uniform tax definitions and exemptions. Rates are simplified, and the state takes on administration for all jurisdictions.[10] It also sets up a voluntary compliance system that retailers can choose to join. Approximately 1,200 retailers in streamlined states voluntarily collect sales tax. Those sellers have collected over $468 million in sales tax for streamlined states.[11]



Arizona is not a participant in the streamlined agreement. Sales tax is complex in Arizona. With many rates and exemptions, the changes needed to join the streamlined states would be substantial. In 2002, Arizona passed legislation to participate. The policy "sunseted" and Arizona stayed on only as an observer. The key for Arizona's participation likely will be federal legislation. For Arizona, revamping its system from transaction privilege to true sales tax and adopting the system's broader definitions could be costly, although it may also bring in more revenue.[12]

DOR estimated that conforming could cost $90-120 million annually with local effects as well. In 2003, the Transaction Privilege Tax Committee of the Citizens Finance Review Commission evaluated the streamlined agreement for Arizona:

Pros

- Potential increased state and local tax revenue from remote sales, provided Congressional approval
- Uniform tax burden between main street and remote vendors

[8] Azeff, Althea, "The Sales Tax Buzz Top 10 Sales & Use Tax Legislative Developments of 2009," *Sales Tax Buzz*, salestaxbuzz.org.
[9] *Internet and Remote Sales Tax Collection: The Application of the Streamlined Sales Tax Statute in Arizona*, Transaction Privilege Tax Research Committee, Citizens Finance Review Commission, August, 29, 2003.
[10] Streamlined Governing Board
[11] www.streamlinedsalestax.org/index.php?page=faqs

- Ease of administration of tax for vendors
- Increased efficiency for administrative procedures
- Simplification of a very complex tax system

Cons

- Potential revenue loss from switch to sales tax from vendor-based transaction privilege tax[13]
- Potential loss of revenue due to broader definitions of existing exemptions
- Uncertainty of revenue impact at each level of government
- Diminished control of tax base and rates at the state and local level[14]

The 2003 committee concluded: "Many states have adopted SSTA conforming legislation already. There is much work to be done if Arizona is to move forward as well. The Commission has been asked to review Arizona's tax policy and systems. The SSTA is clearly one method for reform, and should be considered further."[15]

Today, the streamlined course is just one way states are trying to tap e-commerce. New York, North Carolina, California, and others are trying "Amazon taxes." These states are looking in part to expand definitions to pick up "affiliate" marketers, such as the ones putting up the advertising to drive shoppers to retailers. New York has prevailed in legal battles thus far and expects to collect approximately $70 million by the end of 2009. Florida, Illinois, Minnesota, Tennessee, and Texas have also been considering legislation.[16] Arizona is not missing all online activity however. The state collects a digital download tax along with 17 other states. These taxes are intended to bridge the gap between buying locally and in cyberspace. Music is the primary target.

Arizona could have its own version of an Amazon tax. Since the online giant opened distribution centers in Goodyear and Phoenix in September 2009, the American Booksellers Association asked the Arizona Department of Revenue to require Amazon to collect sales taxes on purchases made by Arizona residents.

A nationwide policy on online revenue is likely to become a reality at some point. Arizona should look closely at its system to be ready to find the gains in this 21st commerce.

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[13] As noted in the CFRC report (see endnote 8) Arizona imposes transaction privilege tax, not a sales tax. The distinction is that the transaction privilege tax is a tax on the private vendors, but a sales tax is on the transaction and both the U.S. government and the Indian nations are exempt from sales tax as sovereign nations. Thus, revenue could be lost.

[14] *Internet and Remote Sales Tax Collection: The Application of the Streamlined Sales Tax Statute in Arizona* Prepared for the Citizens Finance Review Commission p.8

[15] *Internet and Remote Sales Tax Collection: The Application of the Streamlined Sales Tax Statute in Arizona* Prepared for the Citizens Finance Review Commission p.8

[16] Azeff, Althea, Online Sales Tax Roundup: Internet Cowboys & Cowgirls, Open Your Eyes, Updated April 14, 2009, *Sales Tax Buzz*, salestaxbuzz.org.