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Highlights

- Shifting business models, such as digital technology and social media, are creating unique consumption tax issues for global retailers selling within and into the United States.
- The physical presence requirement for state and local sales tax collection responsibility, long a protection for out-of-state and global retailers, is gradually being eroded as jurisdictions expand their definitions.
- If enacted, the Marketplace Fairness Act of 2013 would require—in many states—businesses with no physical presence other than an online retail site, to collect sales tax from customers in that state.

Taxing Internet commerce: What global retailers need to know

With the availability of high speed Internet access, smart phones, and tablets, it is not surprising that the global retail industry is experiencing a fundamental shift in how individual consumers research, select, and eventually purchase products. Individuals are shopping through a variety of different channels, some physical, some virtual, making for an easier and more streamlined shopping experience. E-commerce has quickly become a key channel for retailers to reach their customers. This embrace of digital technology and social media is creating a new landscape for retailers as they ensure that their policies and practices support these changes. These shifting business models are creating unique consumption tax issues for global retailers selling within and into the United States.

The backstory: US indirect/consumption taxes

The US does not have a territory or federally-imposed tax on consumption such as the value added taxes that are customary in many countries around the world. Instead, each of the 50 states, the District of Columbia, territories (e.g., Puerto Rico), and thousands of local jurisdictions have the option to impose their own consumption taxes. Currently 45 states, the District of Columbia and Puerto Rico have consumption taxes, generally referred to as sales and use taxes. Thousands of municipalities and counties also impose sales and use taxes. Each has its own unique rules, rates, and exemptions. Consequently, compliance can become very complex.

Sales taxes are generally imposed on the final consumer of the good or service, but it is the legal responsibility of the retailer to collect and remit the taxes to the various states. However, taxing jurisdictions cannot legally require a retailer to collect and remit taxes unless the retailer has a physical presence in the jurisdiction. To offset the inability to require an out-of-state business to collect sales taxes, most states impose a complementary use tax on purchases by people who buy goods online or out of state and do not pay sales tax. Ideally, consumers would track all of these purchases and remit use taxes to their taxing jurisdiction for the use of the products purchased. However, most consumers either ignore or are not aware of these requirements, and it is impractical for tax jurisdictions to enforce payment of these use taxes by individuals.

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Click-through nexus

Given how rapidly the retail industry has evolved into a complex online, multichannel shopping model, many taxing jurisdictions within the US are left trying to secure existing tax revenue streams using outdated statutes and regulations. Consequently, these jurisdictions have begun to look for new ways to meet the physical presence requirement and enforce collection responsibilities on out-of-state and global retailers. It should be noted that not being required to file US income tax returns due to federal treaties does not necessarily exempt a company from having to collect and remit sales and use taxes, since states are not obligated to abide by federal treaties. Therefore, global retailers not required to file US federal income tax returns could be liable for collecting sales and use taxes if physical presence is established within a taxing jurisdiction.

And finding ways to establish physical presence is just what taxing authorities are attempting to do.

Since 2008, a multitude of states have enacted and/or proposed legislation to allow them to enforce collection responsibilities on out-of-state and, most likely, global retailers. Such legislation is often called 'click-through nexus.' Although the details and tax collection methods in enacted and proposed click-through nexus legislation vary among states, there are several common elements.

With common click-through nexus provisions, states presume that a commission-based relationship between an out-of-state or global Internet retailer and an in-state business or individual that helps facilitate the sale of that retailer's goods over the Internet creates a physical presence for the retailer. Generally, this facilitation occurs when the in-state business or individual places on its website a link to the retailer's website and receives commissions from sales generated through the link. Since states must establish an in-state physical presence in order to require an online retailer to collect and remit sales taxes, laws such as these are meant to establish that such in-state businesses are acting as agents for the online retailer. Consequently, through the use of these commission-based websites, an online retailer, whether US or global, has nexus and a collection responsibility with the taxing jurisdiction in click-through states. These laws can be rebutted, but it can be difficult.

Will the US taxman catch global retailers?

For years, the US Congress has debated the issue of online sales tax. Until recently, the subject faced staunch opposition from many in Congress. Three federal bills were proposed and failed in 2012 alone—the Main Street Fairness Act, the Marketplace Equity Act, and the Marketplace Fairness Act.

However, the tides may have recently turned: In May of this year, the Senate passed the Marketplace Fairness Act of 2013 (S.743), which would allow states to require remote sellers to collect and remit sales and use tax on sales to in-state residents, *even if the retailer has no physical presence in the state*, if the retailer meets certain sales thresholds and the states simplify specific aspects of their laws as required by the Act. In its current proposed form, this bill does not create or increase existing taxes but instead gives states the authority to enforce sales and use tax laws on out-of-state e-commerce retailers. The bill now faces debate in The House of Representatives. Through its broad wording, the bill appears to allow states to apply its provisions to global retailers, as well as US retailers. This interpretation has been supported by comments from the bill's sponsors. For example, according to Christine Mulka, a spokeswoman for Sen. Dick Durbin of Illinois, one of the sponsors of the bill, "The Marketplace Fairness Act treats foreign corporations the same as it does domestic corporations. All online retailers that make over $1 million in remote [US] sales, regardless of where the retailer is located, must collect and remit sales tax to states that require it."[1]

Politically, proponents view the Marketplace Fairness Act as leveling the sales tax collection playing field between Internet and brick and mortar retailers. Opponents feel that the Act would create oppressive compliance requirements on online retailers with over $1 million in remote US sales, as they would have to collect sales tax on every purchase in states that meet the Act's simplification requirements. Instead of sales tax collection being limited to states where the retailer has a physical presence, under the Marketplace Fairness Act, a business that has no physical presence, has never advertised and has never done anything to attract customers in a respective state, other than having an online retail site, will be required to collect sales tax from its customers in that state. If enacted, the tax will be collected from consumers based on where the item is shipped.

More efforts to expand physical presence

In addition to click-through nexus laws and the Marketplace Fairness Act, many states have expanded their definition of physical presence to include the activities of related members or any other person performing activities in the state that could be deemed as helping build an online retailer's in-state market. For example, the presence of a related subsidiary or utilizing a third party distribution center in such states may create nexus for an Internet retailer that otherwise would have no contact with the states. Some states have gone so far as to take the position that the use of the same or similar trademarks by an in-state business and the Internet retailer can be enough of a connection to require the Internet retailer to collect and remit taxes. Prior to enacting these laws, collection requirements were generally based solely upon each individual entity's actions and physical presence.

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[1] Quoted in EcommerceBytes 6/5/13.

The best strategy: Be prepared

Global retailers providing goods and services using a multichannel shopping model will want to be aware of the changing US tax climate toward online shopping. Based on the fundamental shift occurring in the retail industry, many states' current fiscal positions and a reluctance to enact new taxes, retailers can expect to see more measures targeting the collection responsibilities of out-of-state and global retailers. Combined with Congress' increased interest in this issue, it appears that the sales tax differential between online and Main Street sales may be coming to a dramatic end.

It's a debatable question whether US states would or could target overseas companies, but for reputational reasons alone global retailers may want to comply. E-commerce retailers may want to review their systems and staff capacities to see if they have the ability to collect and remit taxes, especially if the federal law is enacted, as it is possible that they could be required to file sales tax returns in numerous US local jurisdictions.

Resources

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