

January 28, 2015

Chairman Bob Goodlatte
Committee on the Judiciary
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Goodlatte,

The Marketplace Fairness Coalition has been looking forward to reviewing federal legislation to provide price parity at the point of purchase. Such legislation is needed so that community-based merchants no longer have to compete against online sellers that have a de facto government-sanctioned price advantage. The release of the draft version of the Online Sales Simplification Act (OSSA) embodying the hybrid-origin proposal provides an opportunity to discuss in more specific terms what will work and what will not work for our nation's dynamic marketplace. We are pleased the draft OSSA recognizes that remote sellers in today's modern world of e-commerce should collect and remit sales taxes like millions of community-based businesses in the U.S. do today.

The most important outcome of this process to the Marketplace Fairness Coalition is agreement on a system that will function in practice and provide a level playing field for all sellers. The MFC sees two essential aspects for a solution for the collection of remote sales and use taxes: (1) price parity at the point of purchase; and (2) a system that will function in the marketplace. The Marketplace Fairness Coalition believes that price parity at the point of purchase is important because that is the true basis for a level playing field.

It is our conclusion that the system currently provided for in the OSSA legislative draft will not provide price parity. As well, we have significant concerns that the proposal as currently drafted will not work in practice in today's omni-channel marketplace. The draft admirably addresses some of the issues raised regarding the hybrid-origin proposal as it was initially set forth at the March 2014 hearing; however, we are concerned this proposal creates additional unintended consequences that will undermine the retail and wholesale sectors for online, brick-and-mortar and omni-channel sellers. We have outlined issues, alternative options and areas of agreement below and respectfully request a meeting with you at your earliest convenience to discuss this proposal and next steps.

Parity at the point of purchase

Creation of two sales and use tax systems: As a result of the provisions in the OSSA draft, different tax rates would apply for remote sellers, which instantly creates a bifurcated system that makes price parity difficult, if not impossible, to achieve. Many retailers and wholesaler-distributors in today's marketplace are increasingly operating as omni-channel sellers. Under the legislative draft, these sellers would have to comply with two separate sales and use tax systems simultaneously. We believe a single system based on destination sourcing that applies the same set of rules to all sellers, rather than multiple systems with fundamentally different rules, is the appropriate way to address this issue.

Price parity not possible with origin sourcing: We do not believe that price parity can be realized under an origin-based sourcing system for two main reasons. First, the origin state and the destination state will rarely, if ever, have the same tax rate. Thus, the approach inherently lacks parity at the point of purchase because different rates could be applied to the same products. Second, the origin state and the destination state will rarely, if ever, have the same tax base. There may be exemptions for sales of certain items, such as clothing, food, and medical devices, which are exempt for tax policy reasons. Because the origin state and the destination state will have different tax bases, the tax will not be the same at the point of purchase. We believe that, as an alternative, considering destination sourcing with a hybrid-model, depending on the structure, could solve the problem of parity at the point of purchase.

Workability in the marketplace

Definitions of physical presence and origin state determination are problematic: While the determination of the origin state as set forth in the OSSA draft attempts to address concerns that were raised regarding remote sellers trying to “game the system,” the method of determination does not acknowledge the realities of omni-channel sellers that have multiple locations in various states. The definition of physical presence in the legislative draft is based upon the activities of the legal entity making the sales. The determination of the origin state is based upon the highest number of employees of the seller’s controlled corporate group. This will be difficult to administer because the controlled corporate group may have many employees who have no connection to the remote seller’s legal entity. For example, the highest number of employees of an omni-channel seller could be determined by the state in which the corporate group has the most brick-and-mortar stores, even if the operations and employees of the legal entity that is the remote seller have no employees in that state.

Unintended costs of multiple tax systems: Certainly any legislation on this issue will come with costs to transition to a new system. However, unlike other proposals, there is no provision in the OSSA draft to address these costs. While it may seem simple for remote sellers to collect where they are located, this creates many problems for multi-location, omni-channel sellers and those that currently collect. Omni-channel retailers and wholesaler-distributors will have to adapt their current systems to comply with two separate taxing regimes. This will entail significant costs to update current platforms. Additionally, sellers that have physical presence under current law and have already begun collecting at the destination rate may be classified as remote sellers under the legislative draft. These sellers will have to convert their current software systems to collect by origin instead of destination sourcing and will be forced to do so even if they would prefer to collect at the destination rate.

The treatment of NOMAD states: Another concern that has been identified is centered on the provisions associated with the states without a sales tax (NOMAD states). The legislation attempts to address these problems; however, it is unclear whether a remote seller in an origin state that is also a NOMAD state will be required to adhere to the legislation if the origin state does not participate in the Agreement. Remote sellers in NOMAD states are given the option to either: (1) provide sales information to the clearinghouse for use tax enforcement; or (2) collect tax from the customer at the lowest rate in the contiguous 48 states (as determined by the commission), using a list of common exemptions (also established by the commission). There is no incentive for NOMAD sellers to collect the tax, so remote sellers in NOMAD states will essentially operate under current law, except they will provide information to the clearinghouse for use tax enforcement, which raises consumer data privacy concerns. States would need detailed information about what was purchased to determine if the item is

taxable and the appropriate rate due. Additionally, as you may know, states like Colorado and North Carolina passed similar legislation that required reporting of sales for use tax enforcement purposes and those laws were negated by federal litigation, further underscoring that this option is unworkable. Nevertheless, the fact that these sellers would not be required to collect the tax ensures that lack of price parity at the point of purchase will remain.

Uprooting a consumption tax-based system: Also of concern is how a state could impose a tax on a customer who has never entered the state. The legislative draft would apparently require the states to change their laws to impose the tax on the remote seller, rather than the customer. This will certainly create problems, but given that the requirement is so different from current law, it is difficult to determine the implications of the change. For the most part, sales and use taxes are consumption taxes and imposed either where transfer of title and possession occurs, or where the consumer can first use the product. The legislative draft proposes to change the current law so that the sales and use taxes are costs imposed on a business' behavior, not costs imposed based on the consumer's behavior or location.

Challenges with formation of the commission and implementation of an agreement: A new issue that the OSSA draft raises is the potential for significant delay related to implementation of the agreement and the formation of the commission. We have major concerns with how the commission itself will be formed, selected and initiated, including, but not limited to, the time frame for drafting, the ratification by the states, approval by multiple federal agencies and a period of time for Congress to reject the agreement and effectively overturn the law by a simple majority vote. Furthermore, under the current OSSA proposal, it appears that a 200-person commission would have 90 days to draft the agreement before the change in physical presence occurs. We believe that the size and make-up of this commission is burdensome and unworkable.

Even if the draft is completed in 90 days, there is potential for further delay. The current OSSA language requires approval of the agreement by a majority of states. Given that many state legislatures meet during a short period or on a bi-annual basis, it is difficult to see how this agreement will be approved by a majority of states in a rapid time frame as is required before a single state can begin to collect. This and the time it will take for federal agency and Congressional approval will significantly delay implementation and impact the ability to create parity at the point of purchase. In fact, under this progression of events it is difficult to imagine a scenario in which this agreement is ever effective. As an alternative, we suggest that legislators look to leverage existing multi-state entities, such as the Streamlined Sales and Use Tax Governing Board, to hasten the process. In fact, there is precedent for such a step as the International Fuel Tax Agreement was based on a multi-state agreement that was already in existence before federal legislation was passed.

Advantage given to foreign sellers: The Marketplace Fairness Coalition is increasingly concerned about a tax advantage given to foreign sellers selling to U.S. consumers. As outlined in the legislation, if a remote seller has an origin jurisdiction in a foreign country and the foreign country imposes a consumption tax on U.S. sellers, then the remote seller is treated as a NOMAD seller. Unfortunately, there is no provision as to how this would be enforced and the term "consumption tax" is not defined. Additionally, there appear to be no provisions that would address how a remote seller in a foreign jurisdiction without a consumption tax imposed on U.S. sellers would be treated, thus suggesting that they are exempted. Furthermore, because origin states may impose sales and use taxes on remote sellers for all remote sales, it seems remote sellers exporting to foreign consumers would be subject to

sales and use tax on remote sales into a foreign jurisdiction while sellers importing to US consumers would not be. We believe that the provisions regarding foreign sales warrant further consideration and review.

Unique challenges impacting wholesalers: In addition to representing many retailers across the country, the Marketplace Fairness Coalition also represents several wholesaler groups. The legislative draft preempts the imposition of a use tax when a remote seller collects sales tax in the state of origin. Included in the legislative draft is a limitation of this preemption, such that it does not apply to business purchases. However, “business purchases” are not defined in the legislative draft. As well, the mandated creation of a uniform compliance certificate and the requirement of each state to develop its own procedures for granting compliance certificates is unclear and problematic. These provisions should be reviewed carefully before proceeding.

Areas of agreement

There are a handful of areas of agreement within the legislative draft. First, we support efforts to limit audits to the state in which the seller is located. Businesses should not be subject to significant audit burdens in states in which they do not have a physical presence. We also support efforts to lessen the burden on businesses by allowing them to self-pay use taxes on their purchases directly to the state instead of paying sales tax on a transaction-by-transaction basis. As well, the Coalition supports efforts to explore the value in giving federal courts jurisdiction over remote sales tax issues. While we agree with the desire to make compliance easier for sellers, we strongly believe that any system based on origin sourcing does not achieve this goal for the reasons mentioned above.

As we have analyzed the legislative draft during this short time frame, we have found that it becomes extremely complicated to apply its language to various real life scenarios that occur repeatedly every day throughout the country. We are concerned that the incremental steps contained in the legislative draft have created even more challenging issues that we fear may be insurmountable in solving this problem. The complexity of determining an origin state, the formation of an entirely new multi-state compact / organization, the difficult expectations placed on such an organization, the potential for delay in state ratification and federal review, the unresolved foreign seller issues and the issues for NOMAD states should be revisited in the near future keeping in mind the overarching goal of price parity at the point of purchase.

In closing, we are encouraged by your suggestion that remote sales tax legislation should be addressed along with ITFA. We appreciate the thoughtful work that has gone into this draft legislation and we want to meet again with you to discuss the sourcing of tax on remote sales, structure of a hybrid collection regime and other concerns that may arise through additional analysis. The Marketplace Fairness Coalition looks forward to working with you and your committee to enact legislation early this year.

Sincerely,

The Marketplace Fairness Coalition

To learn more about the more than 3 million businesses and civic organizations that are part of the Marketplace Fairness Coalition please visit www.marketplacefairnessnow.org.