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## Financial X

### Internet Sales Tax: Is It In Your Future?

By Bruce Haffey

For anyone engaged in sales over the Internet, life may soon get more complicated. For years, individual states have been severely limited in their ability to tax Internet sales, but legislation introduced in 2007 would allow states to begin collecting sales tax.

Based on the U.S. Supreme Court's 1992 decision in *Quill Corp. v. North Dakota* and prior cases, individual states were precluded from requiring out-of-state sellers with no or minimal physical presence in a state from collecting sales tax on sales to purchasers located within the state. The *Quill* case involved an out-of-state mail order house, but the same principles apply to Internet sellers. Where an out-of-state mail order or Internet seller also has a physical presence in the state, such as retail outlets or a regular sales force, the individual state may require the seller to collect sales tax.

Consumers who purchase goods from out-of-state without paying sales tax may be legally required to pay use tax in their home states. However, this is difficult to police and most consumers are probably unaware of it. Accordingly, under current law and the current law enforcement regime, the use tax is rarely collected.

For many years, the lost revenue from sales and use tax on interstate sales was not thought to be significant. Nevertheless, as commercial activity on the Internet expands and individual states increasingly suffer budget crises, the pressure increases to find a way to collect tax on interstate sales. The estimated revenue the state of Michigan would collect on Internet sales is \$350 million, nearly 1 percent of Michigan's total government budget of approximately \$42.4 billion.

After the *Quill* case, a group of individual states began to work on a voluntary system of collecting sales tax on interstate sales without violating the Supreme Court's decision in *Quill*. This resulted in the Streamlined Sales and Use Tax Agreement (SSUTA). Under the SSUTA, participation by individual states and retail sellers is voluntary. To become a member, a state adapts its sales tax laws to the SSUTA standards. There are currently 19 member states. A seller who registers is required to collect and remit taxes to each of the member states, but is granted amnesty for prior years. This is a substantial benefit to sellers with some physical presence in a state, as they are in a "gray" area in terms of being legally liable for sales taxes.

While SSUTA is a step forward, individual states continue to seek a more comprehensive way to collect sales tax from out-of-state sellers. The decision in the *Quill* case left open a door for Congress to adopt enabling legislation.

In August 2007, the most recent effort was the introduction of the Sales Tax Fairness and Simplification Act in Congress. This legislation would essentially make the SSUTA system mandatory, and would require sellers to collect and remit sales tax to all SSUTA-member states.

To minimize the burden on small Internet sellers, the proposal contains a small-business exemption: (a) a business is exempt if either it grosses remote taxable sales of less than \$100,000 in the previous year, or (b) the business, together with all affiliates, grosses remote taxable sales of less than \$5 million.

Similar to prior efforts at federal legislation, there is no indication of imminent passage of this bill. It has strong backing from state governments, due to the lost sales tax revenue, and from "brick-and-mortar" retailers, who suffer a competitive disadvantage. Due to more pressing issues on the federal agenda and the likelihood that this legislation would be characterized as a tax increase during an election year, it is unlikely to be enacted until after the federal elections in November 2008. Still, it is only a matter of time until a version of the Sales Tax Fairness and Simplification Act is passed. Then, life truly will become more complicated for those engaged in sales over the Internet.

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