

The Marketplace Fairness Act of 2013 By: Logan Albright

Introduction

The rise of internet commerce has led to a dramatic reshaping of the way business is done in the American economy. Retailers such as Amazon.com have discovered an entirely new business model, leading lawmakers to question whether existing regulations are adequate to account for the new technology. Both Congress and the Supreme Court have repeatedly wrestled with the issue, but no solid consensus has emerged and to this day the issues, particularly those relating to taxation, remain muddled. Current federal laws do not require online retailers to collect sales taxes outside states in which they have a physical presence, or “nexus.”

A new bill entitled the Marketplace Fairness Act of 2013 (S. 336),¹ however, authorizes an interstate compact that would allow states to require online retailers to collect taxes on remote sales. The bill, introduced by Mike Enzi and sponsored by a large group of senators from both parties, is being sold under the claim that online retailers currently enjoy an unfair advantage over brick and mortar stores, and that the goal is simply to level the playing field and allow honest competition. This paper will examine that claim, as well as the constitutional authority for the bill, or lack thereof.

Proponents of the Marketplace Fairness Act argue that brick and mortar stores are placed at an

unfair disadvantage compared to online retailers. Not only do these stores have to pay rent and maintenance costs for a physical location and employ sales people, they also must collect sales tax on every transaction. All of these expenses necessarily raise prices, and their ability to remain competitive is compromised.

With this in mind, the requirement of online retailers to collect taxes merely serves to give physical stores a fighting chance, by requiring equal treatment under the law with respect to taxation. How could anyone oppose a simple leveling of the playing field?

Do Internet Taxes Really Level the Playing Field?

In fact, there is significant reason to doubt that this bill accomplishes what it claims. There is a fine line between promoting fair competition and protecting certain groups from their own failures, and it is far from clear on which side of the line the Marketplace Fairness Act falls. Before we simply accept that a federally mandated internet sales tax is “fair,” let’s examine some of the ways in which such a requirement would actually put online firms at a substantial disadvantage to competitors.

To begin with, there is the simple cost of administration and compliance. A brick and mortar store needs only to keep track of a single set of tax laws, those of the city or state in which it is physically located. On the other hand, the proposed bill would require online retailers to comply

¹ Bill text available at:
http://www.enzi.senate.gov/public/index.cfm/files/serve?File_id=5c361440-337e-4ddb-ab4d-9c5d871eb589



simultaneously with the laws of dozens of different tax jurisdictions, and while the bill includes a requirement for states to simplify their tax laws,² this is still a costly and burdensome requirement that brick and mortar stores avoid.

Just as brick and mortar stores have expenses not applicable to online sales, the reverse is also true. Online retailers are faced with the problem of home delivery, where shipping expenses can be considerable and easily outweigh even the highest tax rates in the country. Additionally, physical stores enjoy a significant time advantage in that a purchaser has instant access to the product, whereas a customer of an online store must wait several days receive it. It is difficult to quantify the time cost involved in online retail, but it would be unwise simply to dismiss it.

At this point we would do well to step back and examine the reason for state sales taxes to begin with. Such taxes do not, or at least should not, exist simply to raise revenue or to punish businesses, but are instead used to fund local projects that give benefits to the entire community. Cities tax their residents to pay for roads, because everyone in the city benefits, directly or indirectly, from a well maintained transportation infrastructure. A local business cannot sell its wares if customers cannot get to the store, and for that they need roads.

However, an online retailer with no physical presence in the state reaps no such benefit from local spending, and it therefore makes no sense that they should be forced to pay for it in the form of taxation.

From an economic standpoint, a big problem with the destination-based system of collecting sales taxes is that it hinders the states' ability to compete with one another to attract business and find optimal policy solutions. A business friendly tax policy can be a major incentive for a business to locate in one

state over another, but if tax collection is irrespective of the physical location of the company, this incentive is removed.

This matters because without such incentives, there is little to stop states from raising their sales tax rates to exorbitant levels in order to collect revenue. The consequences of doing so are diminished, since they will not lose business from online retailers based locally.

The purpose of a federalist government is to allow the states to serve as laboratories for economic policies, to find out what works and what doesn't. The destination-based system of taxation is harmful to this function and will remove an important deterrent from state governments acting badly.

Finally, it should be pointed out that the distinction between brick and mortar and online retailers is not as clear as some would have us believe. Most larger retailers sell products both in physical stores and over the internet, so it is unclear how current laws discriminate against them. Stores such as Barnes & Noble cannot truly be said to be at an unfair disadvantage to Amazon.com, because their online stores are essentially identical.

Constitutionality

As with so many issues relating to new technology, it can be a challenge to interpret the constitution to account for things the framers never could have foreseen. The articles of the constitution dealing with taxation and interstate commerce are vague, perhaps intentionally so, and as such there is now considerable debate over whether taxing out of state sales of online retailers should be permitted under the Constitution.

The crux of the debate over the constitutionality of the Marketplace Fairness Act rests on a 1992 Supreme Court decision³ claiming

² *What Is the Marketplace Fairness Act?*

<http://www.marketplacefairness.org/what-is-the-marketplace-fairness-act/>

³ *Quill Corp. vs. North Dakota (1992)*

<http://www.law.cornell.edu/supct/html/91-0194.ZO.html>

that a business must have a nexus, or physical presence, in a state before that state can require them to collect sales tax. This would seem to be a clear cut ruling against the destination-based taxation of online sales, but due to subtleties in the wording of the Court's decision, it is unclear exactly what constitutes a nexus. Some have argued that a nexus encompasses any physical business done within the state, including dealings with independent sellers called "affiliates."⁴

Ultimately, the definition of "nexus" will have to be decided in order to determine the constitutionality of the act, but even if a nexus is defined in the broader sense, there is another reason to suspect that the Constitution may prohibit this type of remote taxation.

The Commerce Clause of the Constitution prohibits discriminatory laws regulating interstate commerce.⁵ This was designed to prohibit tariffs or duties between the states, and would render any law invalid if it subjects out of state retailers to any burdens not borne by businesses within the state. If the Marketplace Fairness Act can be interpreted as discriminatory in the requirements it places on online retailers, it would be rendered *per se* invalid by the Commerce Clause.

The Marketplace Fairness Act requires a destination-based system of taxation, meaning that the applicable tax rate to an online purchase is based on where the customer is located, not the retailer. If tax must be collected at all from online purchases, it makes far more sense to use an origin-based system, where the tax rate is determined by the business location.

An origin-based approach solves several of the problems outlined above. It preserves inter-state

competition, it reduces the administrative burden and it allows the tax dollars to be reinvested in a way that will benefit the businesses responsible for generating the revenue.

Conclusion

Supporters of the bill argue that the current situation is unfair to brick and mortar stores, but it is unclear why this is the case. Each business model has a specific set of advantages and disadvantages associated with it, and the fact that one yields a lower cost structure is not fundamentally unfair to the other. Instead, this appears to be a case of an industry being outpaced by technology and seeking government assistance to protect itself from change.

Any increase in the price of doing business online will result in higher prices and fewer sales. Not only is this harmful to consumers, but also detrimental to the economy as a whole. Protectionism of certain industries and barriers to free trade have never been good for growth, and have been universally recognized as unsound economic policies for decades. They serve only to hold back economic progress and grant special protection to powerful lobbies at the expense of the rest of us.

⁴ *Is Internet Tax Constitutional?*, Forbes.
<http://www.forbes.com/sites/robertwood/2011/04/18/is-internet-tax-constitutional/>

⁵ "Amazon" *Laws and the Taxation of Internet Sales: Constitutional Analysis*, Congressional Research Service.
<http://www.fas.org/sgp/crs/misc/R42629.pdf>