Remote Possibility

Governor's Risky Bet on Federal Legislation

The Commonwealth Institute

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Governor McDonnell is rolling the dice with his transportation funding package: more than one-third of the revenue he's banking on requires that Congress passes legislation allowing Virginia to require out-of-state ("remote") sellers to collect sales taxes when they sell something online to a consumer in Virginia. That's not as simple as it sounds.

Taxing purchases made over the internet has been the subject of heated debate for decades and has so far gone nowhere at the federal level. Simply assuming Congress will act in a way that yields new revenue for Virginia this year amounts to a risky bet, not a real transportation funding solution.

Background

The push for federal legislation is a result of the 1992 Supreme Court decision (*Quill v. North Dakota*) that established "physical presence" as the threshold for requiring remote sellers to collect state sales taxes. In other words, states are not allowed to require companies without physical presence in their state to collect and remit sales tax. However, since Congress has constitutional authority to regulate interstate commerce, federal legislation could reverse the Quill decision.

Although Governor McDonnell specifically called out the Marketplace Equity Act (MEA) of 2011 (H.R. 3179) when introducing his proposal, that bill is just one of three competing federal remote seller proposals at play. Passage of any of these bills would grant Virginia the authority it needs to require that remote sellers collect sales taxes. But the amount of revenue Virginia would gain varies according to the specifics of each proposal. In addition, the likelihood of any one of these bills passing Congress is minimal.

The near-term political outlook for remote seller legislation is murky

Strong and vocal opposition by business groups and anti-tax legislators darkens the governor's optimistic outlook for the timely passage of any remote seller legislation. Just because a bill like the MEA has Republican and Democratic co-sponsors does not mean that the bill has full bi-partisan support. For every supporter who states that this proposal would not create a "new" tax but is, instead, an attempt to collect taxes that are already owed, there is an opponent to argue otherwise. In addition, while the concept of remote seller legislation is being discussed, none of the bills from the previous session of Congress has yet been reintroduced. So, there is no bill in Congress to do what the governor is banking our transportation funding on.

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Should a remote seller proposal become law in 2013, the revenue impact is uncertain

The failed remote seller proposals from previous sessions of Congress vary in key ways that, if reintroduced and passed, could result in very different revenue impacts for Virginia. For example, the MEA exempts small business remote sellers with gross annual receipts nationwide of $1 million or less, or statewide of $100,000 or less. Should the exemption be modified and the definition of a "small business" be expanded, fewer

businesses would be affected and Virginia would collect less revenue.

Another possible scenario is that in order to satisfy the many members of Congress who have signed the "no-tax pledge," remote seller legislation could be paired with some other tax cut in order to keep the package revenue neutral. For example, the MEA could be paired with another bill that preempts some other state tax, such as the Business Activity Tax Simplification Act (BATSA). Introduced by Rep. Bob Goodlatte (R-VA), BATSA would replace state-defined physical presence thresholds with a higher federally-defined threshold, leading to substantial revenue losses for states. If tax cuts are paired with remote seller legislation in order to garner sufficient support, Virginia might not see any new revenue at all.

A Better Bet

If state policymakers are serious about modernizing Virginia's sales tax and bolstering revenue collections from e-commerce activity, there are **state-level** solutions available. In 2012, Virginia took a step in the right direction by passing legislation requiring Amazon and other online companies with warehouses in the state to collect sales taxes on sales made to purchasers in-state, but more options remain. One example is taxing digital goods and services like audio, books, computer programs, and other files downloaded from the Internet. By extending the state's sales tax to these purchases, Virginia could bring in roughly $11 million more in revenues annually.

Taxing digital downloads is not a radical move and it is fully within the control of the General Assembly. A significant number of states include some digital goods and services in their sales tax base, including:

- 33 of the 45 states that have a sales tax, plus the District of Columbia, tax downloaded computer software;
- 22 of the sales tax states plus the District of Columbia tax downloaded movies, music, and books;
- Hawaii, New Mexico, and South Dakota tax virtually all digital goods and services, just as they tax most other types of services, while Idaho, Utah, and Washington also have very broad coverage of digital goods and services (extending well beyond software, movies, music, books, and games);
- A number of states tax smaller categories of digital goods and services, such as online information databases and electronic greeting cards.

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