



**Statement of John Stephenson
State Government Affairs Manager
National Taxpayers Union
Before the Illinois House Revenue and Finance Committee
Regarding SB 3353**

September 29, 2010

I. Introduction

Chairman Bradley and Members of the Committee, my name is John Stephenson, and I am the State Government Affairs Manager for the National Taxpayers Union (NTU), the nation's oldest and largest non-partisan advocate for overburdened taxpayers. I am honored to appear before you today and to present these remarks on behalf of NTU's 14,000 members in Illinois.

I commend you for holding this hearing on Senate Bill 3353, which would amend the state tax code to establish a taxable presence for out-of-state online retailers with affiliates in the state (popularly known as an "Amazon tax"). NTU has serious concerns about this legislation and, therefore, I urge you to oppose it. Under a mis-defined concept of "fairness," SB 3353 would expand Illinois' taxing power beyond accepted constitutional limits and declare this state's hostility to business, all without yielding much revenue for the state. Rather than impose an unconstitutional and punitive tax policy, Illinois should pursue broad-based tax reforms to bring more stability to the state's finances and foster economic growth.

II. Background

SB 3353 would amend the Illinois's tax code to establish that a person without a physical presence in the state is presumed to engage in taxable business in the state if that person 1) enters into an agreement with an in-state resident by which the resident agrees, for a commission or some other consideration, to refer customers either directly or indirectly, such as through an Internet link, to that out-of-state person, and 2) the cumulative gross receipts of sales from the referrals are greater than \$10,000 during the preceding year.ⁱ

This scheme is known popularly as an "Amazon" or "affiliates" tax because it is aimed at out-of-state online retailers like Amazon with affiliates, namely websites, that link and market goods for the retailer. Currently, only New York, North Carolina, and Rhode Island have enacted laws that create an Amazon tax scheme similar to SB 3353.ⁱⁱ Two states,

Colorado and Oklahoma, have enacted laws that require online retailers to mail notices to their customers reminding them that they owe use tax. Another two states, Alabama and California, have sought to educate retailers and consumers about existing sales and use tax laws. Although the legislatures of California and Hawaii passed Amazon tax laws, the governors of those states vetoed the bills.ⁱⁱⁱ

III. The Problems with Amazon Taxes

While some may regard a bill like SB 3353 as a tax “reform” to promote fairness, it is actually an unwise policy that does not make a tax system fairer or more competitive. States attempting to prey upon online businesses beyond their borders by taxing their in-state affiliates run the risk of inviting constitutional challenges. Moreover, they have not raised the desired revenues. What taxes aimed at online retailers do is declare a state’s hostility to the business community.

A. Amazon Taxes Are Unconstitutional Expansions of the Tax Power

The U.S. Supreme Court has ruled that only retailers with a physical presence, or “nexus” to a state, such as a warehouse, an outlet, or employees located in the state, are obligated to collect the state’s sales tax. As the Supreme Court said in *Quill v. North Dakota*, there are simply too many tax rates and rules in the United States for a retailer to keep track of them all; to do so would impede interstate commerce.^{iv} Although the *Quill* case dealt with a mail-order retailer, the same principle is true for online retail businesses. An online retailer does not have a physical presence merely because a website in Illinois links to the retailer.

States that have enacted Amazon taxes have been sued for violations of the constitution and other statutes. New York, which in 2008 enacted the first Amazon tax law requiring out-of-state retailers to collect sales taxes for online transactions through affiliates in New York, has been sued on this very issue.^v The litigation continues to this day. North Carolina, which earlier this year asked Amazon to provide the names of its customers, has been sued in a federal district court for violations of privacy laws.^{vi} Pursuing a law that is almost guaranteed to invite an expensive, multiyear legal challenge is not prudent and should be avoided.

B. Amazon Taxes Come Up Short in Delivering Revenue

Aside from inviting constitutional challenges, Amazon tax laws have not yielded the promised revenues. Although New York has collected about \$70 million in revenues, this is an anomaly when compared to other states and the constitutional challenge to its tax law raises questions about whether the state can ultimately keep the money that’s left after litigation costs are taken into account. Further, these collections are a drop in the bucket when compared to New York’s \$19 billion budget deficit. Finally, when lower collections of other types of taxes from reduced economic activity are factored in, Amazon taxes are more likely to *cost* the state revenue.

States are already collecting the majority of expected revenue from online transactions due to the physical presence of Internet retailers in most of the states. For example, according to *STORES* magazine, 13 of the top 20 favorite online retailers also have stores and outlets in states throughout the country.^{vii} Moreover, the Internet Alliance, a trade group representing

online retailers, reports that affiliate referrals account for less than 10 percent of the annual revenues for the group's member companies.^{viii} This means that expectations for a large revenue windfall through taxing online retail affiliates are highly unlikely.

In response to the new tax collection and reporting obligations, Amazon has shut down its affiliate programs in Colorado, North Carolina, and Rhode Island. Other online retailers that use affiliates, such as Overstock.com, BlueNile.com, and B&H Photo Video, have followed suit by eliminating or scaling back their affiliates programs.^{ix} As Amazon explained in an e-mail to its Colorado affiliates, the reporting requirement "is clearly intended to increase the compliance burden to a point where online retailers will be induced to 'voluntarily' collect Colorado sales tax – a course we won't take."^x

Ironically, the Amazon taxes have the effect of depriving the states of the very revenues they sought. Without the affiliates, there is simply no tax to collect. Rhode Island has not collected any revenue due to the Amazon law; one business trade group in Rhode Island suggests that the state has collected *less* in tax revenue because the loss of affiliates means less in business income.^{xi} Notably, Rhode Island's gross receipts threshold for tax liability (\$5,000) is half of what New York's law and SB 3353 require.

Now, Frank Caprio, Rhode Island's treasurer, has urged the General Assembly to consider repealing the statute.^{xii} Caprio said, "The affiliate tax has hurt Rhode Island businesses and stifled their growth, as they've been shut out of some of the world's largest marketplaces, and [it] should be repealed immediately."^{xiii} North Carolina reports that it is not keeping track of revenues from the Amazon tax.^{xiv} Collection problems with the New York-style approach are, in part, what led Colorado and Oklahoma to pursue reporting requirements instead. Even some proponents acknowledge that Amazon tax laws do not collect desired revenues in the short term.^{xv} A loss of business activity and revenues is the last thing any state needs during this time of economic uncertainty.

C. Amazon Taxes Declare a State's Hostility to Business

By effectively shutting down affiliate activities, Amazon taxes deliver a blunt message to the business community, especially entrepreneurs and innovators: the state is hostile to new business. The stark reality is that these policies precipitate business closures, leading to loss of revenues for the state, reduced employment opportunities, and higher prices for consumers, which deter entrepreneurs from starting new businesses in the state.

Proponents say Amazon taxes help to "level the playing field" between online retailers and local "brick-and-mortar" retailers. We have heard these types of arguments before. But in reality, these laws punish one business model to give a competitive advantage to another. While brick-and-mortar retailers claim that the online retailers have the advantage, the brick-and-mortars have several advantages over their online competitors, including greater customer-retailer interactions and immediate purchases.

Amazon taxes require online businesses to shoulder a higher cost of compliance due to the very heavy burden of complying with each of the sales tax jurisdictions where the customers reside. The Tax Foundation reports that 8,000 separate tax jurisdictions exist in the United States.^{xvi} Although some tools exist to provide information on sales tax requirements in these jurisdictions, these are not always the most reliable sources of data. Indeed in the

latter area, online retailers, who represent an important segment of the nation's economy, are subject to a competitive disadvantage from brick-and-mortar retailers, who only have to remit the sales tax where they are located.

If Illinois enacts SB 3353, it will be the only state in the Midwest to enact an Amazon tax thus far. There are nearly 9,000 affiliates in Illinois, many of them small businesses, who paid \$18 million in state income tax in 2009.^{xvii} Does this Committee really want to pass a law that would threaten the survival of these taxpayers for revenues that likely will not appear?

IV. Illinois Should Pursue Budget and Tax Reform Instead of Punitive Taxation

Instead of finding creative ways to collect more tax revenue from in-state affiliates of online firms, this Committee should examine ways to make Illinois' tax code simpler, fairer, and more competitive. Illinois currently has the 14th-highest per capita state and local tax burden in the nation.^{xviii} Moreover, the state's business climate ranks 30th out of 50 and the combined state and local sales tax rates are the sixth-highest in the nation.^{xix} Property taxes as a percentage of median home value are also the nation's sixth-highest.^{xx} By taking the path of true tax reform, Illinois can attract more taxpaying individuals and businesses, which will generate more revenue for the state and encourage economic growth through which all Illinoisans can prosper.

V. Conclusion

NTU strongly supports efforts to improve Illinois's tax code for the benefit of the state and its citizens, both current and future. But enacting SB 3353 and taxing the affiliates of online retailers is not the correct way to proceed. NTU and its members stand ready to work with you in devising proposals that can and will do better. I appreciate the opportunity to present these views and I am happy to answer any questions. Thank you.

Notes

ⁱ<http://www.ilga.gov/legislation/BillStatus.asp?GA=96&DocTypeID=SB&DocNum=3353&GAID=10&SessionID=76&LegID=51208>.

ⁱⁱ <http://www.taxfoundation.org/research/show/25949.html>.

ⁱⁱⁱ Id.

^{iv} <http://www.stateline.org/live/details/story?contentId=479651>.

^v Id.

^{vi} Id.

^{vii} <http://www.stores.org/2010/Favorite-50-List>

^{viii} <http://ctmirror.org/story/5168/amazon-threatens-fire-state-affiliates-if-connecticut-tries-collect-sales-tax>

^{ix} http://www.projo.com/news/content/Amazon_law_02-26-10_21HIT5M_v16.3a62e70.html.

^x <http://www.feld.com/wp/archives/2010/03/amazon-fires-its-affiliates-in-colorado-including-me-because-of-colorado-hb-10-1193.html>.

-
- ^{xi} <http://www.taxfoundation.org/research/show/25949.html>.
- ^{xii} <http://www.stateline.org/live/details/story?contentId=479651>.
- ^{xiii} <http://www.websitemagazine.com/content/blogs/posts/archive/2010/02/03/affiliate-tax-battle-heats-up-in-colorado.aspx>
- ^{xiv} <http://www.taxfoundation.org/research/show/25949.html>
- ^{xv} Id.
- ^{xvi} Id.
- ^{xvii} <http://www.lakeshorebranding.com/company/blog/new-proposed-tax-will-terminate-thousands-of-jobs/>.
- ^{xviii} <http://www.taxfoundation.org/publications/show/2181.html>.
- ^{xix} Id.
- ^{xx} Id.