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The Time May Have Arrived for Online Sales Tax Fairness.

Partially driven by a devastating alternative, Congress appears closer than ever to passing an Internet sales tax bill.

After a March 12 hearing of the House Judiciary Committee, Congress is mighty close to passing an Internet tax bill that would make it possible for states and localities to line their coffers with an estimated $23 billion a year in what are now uncollected sales taxes from online purchases.

"It is looking really good," says Max Behlke, manager for state-federal relations for the National Conference of State Legislatures (NCSL). "The last couple of years people have been saying, 'This is the year, this is the year.' But after last Wednesday's hearing, it really does look like this is the year."

The Senate already passed a Marketplace Fairness Act by a bipartisan vote of 69-27 that would require Internet retailers and catalog companies to collect sales taxes, regardless of whether they have a physical presence in a state. The House has been more reluctant to act, but what has Behlke feeling optimistic is that 37 of 40 members of the House Judiciary Committee showed up for the hearing. "Not all were in support of a bill, but everyone agreed that this is not a new tax" and that, Behlke points out, is a major step forward.

The hearings also showed that there could be worse things than no passage. One of those things is an approach to Internet tax collection, called "origin sourcing," that drew a lot of discussion.

With origin sourcing, instead of basing the Internet sales tax on where the customer resides, it would be based on where the online-only retailer calls home. A firm could base its "home jurisdiction" in the state where it has the most employees, the most physical assets or the one designated by the company as its principal place of business for federal tax purposes. In theory, an online retailer who claims one of the five no-sales-tax states as home headquarters would not have to collect sales taxes from its customers, wherever they may reside and wherever the goods may be delivered. For online-only sellers, changing locations to a no-sales-tax or low-sales-tax state would be fairly easy and could spawn interstate tax competition to lower sales tax rates.

Howard Gleckman, a resident fellow at the Urban Institute, described the approach as a poison pill, "a cynical effort to exempt Internet sales from any tax under the guise of 'fairness' and 'state sovereignty.'" If it somehow became law, he pointed out, "it could well be a recipe for the ultimate demise of sales taxes as a source of state revenues."

Others testifying at the hearing were blunter: Stephen Kranz, a tax partner in the law firm of McDermott, Will & Emery, called origin sourcing "the nuclear bomb version of tax competition."

The only good news about origin sourcing is that Utah Rep. Jason Chaffetz ended his questions to the witnesses with the comment that "origin sourcing is dead on arrival." But the genie is out of the box. If no bill is passed this year, it could resurface again. "That's always a possibility," NCSL's Behlke says. "It's always discussed."

Meanwhile, a few states, taking note of the Senate bill, are making their own adjustments. Some Republican governors and their legislatures don't want the perception that the size of government might grow from the windfall of additional sales tax revenue. Wisconsin and Ohio passed proactive measures that would cut state taxes when the federal e-fairness law is passed by Congress and signed by President Obama. If an e-fairness bill passes, for instance, Wisconsin's law would automatically cut state income taxes for individuals, families and small businesses. "Since most small businesses pay their taxes through their personal filings, the state budget creates the ultimate win-win scenario of tax fairness and a tax cut," says Scott Stenger of the Alliance of Wisconsin Retailers.

The Idaho Legislature has a similar bill before it that would create a savings account where all additional revenue the state collects from federal e-fairness legislation would be directed to local tax relief, instead of being funneled into the general fund.

These reactions to a possible e-fairness law by Republicans is another reason Behlke is positive about passage this year. As he notes, the issue is not going away: e-commerce is growing by double digits, states are losing money and small businesses continue to struggle. "Congress wants to deal with the issue sooner rather than later," he says. "With presidential elections coming in 2016, Republicans want to get this issue off the table."

Every year Bloomberg BNA surveys state revenue officials to clarify their state's approach to the gray areas of state tax law, and this year it looked at the question of nexus — physical location — in terms of sales taxes on services that cross state lines. The results of that survey will be published in its Survey of State Tax Departments *due out April 25.*

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