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The California Bottom Line

Billions of tax dollars go uncollected

> ***California businesses shouldn't be undercut by online retailers whose main competitive advantage is avoiding state sales tax. We can change this!***

—Tamekia Robinson,
Tax Technician II,
California State Board of Equalization

Commentary on California's Budget Crisis from SEIU Local 1000

Billions in uncollected taxes

California is missing out on about $1 billion a year in money, money that's owed—but never collected. And the amount will only grow as more people go online to buy their clothing, electronic gadgets and jewelry from far-flung addresses. During a six-year period ending in 2012, California and local governments will lose out on an estimated $8.7 billion, according to one study, because consumers and businesses annually cheat the state on owed sales tax.[i] "Use tax," virtually the same as sales tax, is supposed to be paid by California consumers and businesses on *all* taxable goods purchased out of state, either online, through mail order or in person. **But it's not.**

According to the California State Board of Equalization, in 2009 the unpaid amount averaged $166 a year for each business and $47 a year for each California household—for a total of $1.085 billion.[ii]

Because of pre-Internet tax laws, a large chunk of the tax on e-commerce sales can only be collected as use tax—through the voluntary compliance of consumers—unless there is new federal legislation. Even though collecting all owed use tax remains unrealistic for now, states are adopting two options that at least begin to capture the burgeoning revenue source. Facing monumental budget deficits, California—one of the largest "losers" nationwide—must get on board with states like New York and Colorado. Both states have passed landmark laws that increase tax collection, either through direct collection by the seller or by reporting consumer and business purchases to the state, which should increase compliance. But California's law could be even more effective.

Estimated California state and local e-commerce use tax (in millions of dollars)

	2007	2008	2009	2010	2011	2012	Totals
Owed	4,898.3	5,223.3	4,699.5	5,827.8	6,852.3	7,702.0	$35,203.2
Collected	3,687.1	3,931.7	3,537.4	4,386.7	5,157.9	5,797.5	$26,798.3
Uncollected	**1,211.2**	**1,291.6**	**1,162.1**	**1,441.1**	**1,694.4**	**1,904.5**	**$8,704.9**

SOURCE: State and Local Government Sales Tax Revenue Losses from Electronic Commerce[iii]

Controversial, complicated but crucial: California must back "Amazon Tax" bills

California's use-tax law dates back to 1935, hardly a new tax, but the state, like other states, has never been able to enforce collection and relies largely on voluntary compliance. Adding a new line on state tax forms requesting payment brought in $11.6 million in fiscal year 2009-10.[iv] With the exploding growth of online sales, more states are looking for other ways to capture what is due to them. New York in 2008 led the way with what is commonly nicknamed the "Amazon tax," after the online retail giant. The law has withstood court challenges so far and will most likely be appealed to the state's highest court. In the fiscal year ending in March 2010, New York has collected $70 million in e-commerce tax revenue that can be attributed to the new law, said Eric Songayllo, a policy analyst with the New York Department of Taxation and Finance. "It's chipping away at the problem," he said. The state also collected $45 million that same year in use tax through a line with an accompanying chart on the state sales tax form.[v]

North Carolina and Rhode Island have also enacted similar laws, requiring sales tax collection by certain "remote" retailers. All these laws are based on a 20th century U.S. Supreme Court decision that gave states the right to impose sales-tax collection on out-of-state sellers with a presence in the state.[vi] Before the days of online selling, that presence typically meant a brick-and-mortar store or a warehouse. Now, these states have extended that definition to what are known as "affiliates," business partners who promote and solicit sales for online sellers and are virtually in every state. In a typical affiliate relationship, an online sports blogger agrees to promote products such as books or running gear for an online seller, providing an online link in exchange for a percentage of any sales. These affiliates have become pawns in the massive defense mounted by Amazon and other online sellers, such as Overstock.com. Both have dropped affiliates in some states, fueling political outrage targeting such laws as "job-killers" and "business

unfriendly."[vii] Yet, Amazon still registered in New York to collect tax from New York purchasers and didn't drop affiliates there.[viii]

California is one of the few states where state legislators supported the idea—only to have the governor veto it. In 2009, Gov. Arnold Schwarzenegger vetoed it from the budget claiming it would raise taxes and drive business out of the state.[ix] Two Assembly bills have been introduced in January 2011: AB 153 by Assemblywoman Nancy Skinner, D-Berkeley, and AB 155 by Assemblyman Charles Calderon, D-Montebello.

Colorado goes innovative with a different take on Amazon Tax

In March 2010, Colorado passed a law that managed to sidestep the whole requirement of a physical presence in the state, which supposedly meant removing the affiliates as political pawns. The new Colorado law covers virtually all out-of-state sales on taxable goods.

Legislators there passed a law that required remote sellers grossing more than $100,000 in sales within the state to either voluntarily collect sales tax or disclose to the state taxable transactions with purchasers' names. Transactions are not detailed beyond the general taxable categories, such as clothing. The law imposes steep fines on sellers for each violation.[x] Unfortunately, the law applies to consumers who spend $500 or more a year on out-of-state purchases, more than the $100 minimum that the Colorado Fiscal Policy Institute had argued for, according to Alec Harris, a policy analyst with the group.

The state has been sued and will go to court in January. Amazon also dropped its affiliates in Colorado, even though the affiliates won't affect the company's tax liability.

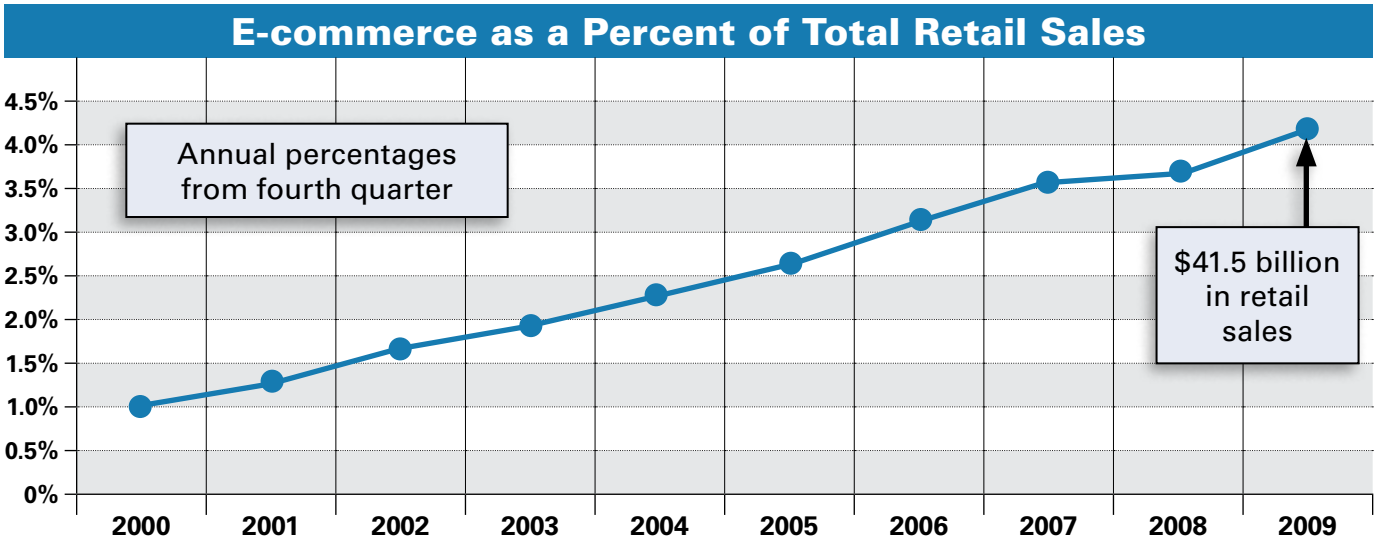
Though Colorado's collected amounts won't be available until April 2011, the state had estimated it would collect about $12.5 million of the estimated $150 million owed use tax under the new law, according to Phil Horowitz, director of the tax policy analysis office in the Colorado Department of Revenue. Harris, of the Colorado Fiscal Policy Institute, said the amount could significantly increase if the $500 minimum were lowered.

National effort moving forward

A consortium of states has organized under the Streamlined Sales Tax Governing Board, which California has not joined. The organization has worked for more than a decade to push for uniform tax codes and federal legislation that would basically eliminate the "physical presence" requirement. Big-business representatives, such as the National Retail Federation, are supporting what is known as the "Main Street Fairness Act." The bill, H.R. 5660, is in committee. The law, though, would only apply to states who joined the Streamlined project and agree to reform its state sales tax code.[xi] The one-size-fits-all approach is not resonating with at least half the states that charge sales tax, including California. The new law could infringe on states' sovereignty, the right to decide on how to tax. Another controversial point in the federal legislation is a requirement that sellers be compensated for the costs in collecting and remitting sales tax. Opponents are pushing to pare down the federal legislation so it only seeks to remove the physical presence obstacle.[xii]

States must move on with legislation to capture their share

Without favorable federal legislation impending, cash-strapped states are moving ahead with their own legislation. The explosive growth of e-commerce (see chart) will leave states in the dust without new legislation tailored for an evolving marketplace.



SOURCE: Retail Indicators Branch, U.S. Census Bureau

California, with its muscle in the marketplace, could lead the nation with effective legislation tailored for the internet age:

- Besides legislation, the state should continue to focus resources on greater compliance through audits and subsequent fines.
- Whatever legislative model California follows, legislation must avoid loopholes or other compromises that might dilute the effectiveness and reduce collected tax.
- California can push for federal legislation that would simply eliminate the outdated requirement of a physical presence, which would let states enforce sale tax collection for all remote sellers.

The two proposed California bills are complementary and feature elements of both the New York legislation and the Colorado legislation. The California's Board of Equalization estimates the General Fund would recover at least $200 million annually (out of $1 billion owed) if legislation passes.

Besides the revenue loss, consider these points:[xiii]

- Brick-and-mortar sellers deserve a level playing field. Small, independent sellers, such as bookstores, are disappearing and cite competition from remote sellers. Online sellers rely on the sales-tax advantage—an estimated $23 billion by 2012. Amazon has stated in U.S. Securities and Exchange Commission filings that, if the company was forced to collect sales tax in more states, it would "decrease our ability to compete with traditional retailers, and otherwise harm our business."[xiv]
- The sales-tax advantage—as much as 8 percent of a sale—is largely unavailable to those who do not have online access or credit cards.
- Technology has also evolved to simplify collection for retailers: Amazon already collects sales tax in virtually every state for Target purchases made through Amazon.
- Illinois state legislators passed a New-York style bill, which awaits the governor's signature as of late January. An editorial in the Chicago Tribune urges a signature so that California and other states "on the fence" will join the effort, diluting the domineering influence of online retailers and pressuring the federal government for a solution.[xv]

Endnotes

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ii. California Board of Equalization Revenue Estimate, Nov. 3, 2009, *http://www.boe.ca.gov/legdiv/pdf/e-commerce-11-09.pdf*

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iv. Interview with Shiela Waters, legislative and research division of California Board of Equalization, Dec. 23, 2010.

v. Interview with Eric Songayllo, policy analyst with the New York Department of Taxation and Finance, Dec. 21, 2010.

vi. Quill Corp. v. North Dakota, 1992, *http://www.law.cornell.edu/supct/html/91-0194.ZO.html*

vii. Michael Mazerov, "Amazon's Arguments Against Collecting Sales Taxes Do Not Withstand Scrutiny," Center on Budget and Policy Priorities, Nov. 29, 2010, *http://www.cbpp.org/cms/index.cfm?fa=view&id=2990*

viii. Interview with Eric Songayllo, policy analyst with the New York Department of Taxation and Finance, Dec. 21, 2010.

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xiii. Michael Mazerov, "Amazon's Arguments Against Collecting Sales Taxes Do Not Withstand Scrutiny," Center on Budget and Policy Priorities, Nov. 29, 2010, *http://www.cbpp.org/cms/index.cfm?fa=view&id=2990*

xiv. Amazon.com, Inc. Form10-K for year ending Dec. 31, 2008, p.14.

xv. Editorial, Chicago Tribune, Jan. 24, 2011, editorial page, *http://articles.chicagotribune.com/2011-01-24/news/ct-edit-amazon-20110124_1_tailers-e-tailers-sales-tax*

LOCAL 1000 SEIU Stronger Together

Service Employees International Union Local 1000 is the is the largest union of state employees, representing more than 96,000 state employees, including prison teachers and the overwhelming majority of white collar professionals, clerical workers, auditors, information technology professionals, planners, inspectors, printers, librarians, custodians, nurses and other health care professionals.