



Business In The Beltway

Point, Click, Pay Tax

Janet Novack, 11.28.07, 11:32 AM ET

WASHINGTON, D.C. - Here's a surprising estimate: Consumers will pay sales tax on half of their online purchases this Christmas.

Avoiding sales taxes has long been one of the lures of shopping online. After all, the combined state and local sales tax levy now averages more than 8.5%, the highest ever, according to Vertex, which sells tax collection software. That average doesn't include Delaware, Montana, New Hampshire and Oregon, which don't have sales taxes.

In theory, a consumer who orders a product on the Web or from a catalogue owes the same sales tax he would if he purchased it from his local store. But the Supreme Court has ruled that a state can only require a merchant to collect the tax if the merchant has a physical presence in the state. That's why Amazon.com, the largest online retailer, collects sales taxes only on items shipped to Kansas, Kentucky, North Dakota and Washington, where it has offices or warehouses.

It's also why the states and the National Retail Federation--an advocacy group for traditional store-based retailers--are pressing Congress to change the law. The House Judiciary Committee is expected to hold a hearing next month on a bill allowing states that sign on to the Streamlined Sales and Use Tax Agreement (a pact meant to make the collection of sales taxes less burdensome) to require all online and catalogue merchants doing more than \$5 million a year in sales to collect their taxes. Such legislation has little chance of becoming law before 2009.

Meanwhile, half the sales taxes owed by consumers on the purchases of goods online are being collected anyway, figures William Fox, director of the Center for Business and Economic Research at the University of Tennessee. He bases that estimate on surveys of Web sites he and his students have conducted over the last two years.

"I was surprised to find it was so high. And if anything, it's growing," says Fox.

Fox stresses the states are still missing a lot of tax money--\$15 billion a year or more. And with online sales climbing 20% a year, their losses will grow. But state enforcement pressures, combined with traditional bricks-and-mortar retailers' success on the Web, has led to increased tax collection online.

Only three of the 20 largest online merchants in 2006 were pure online operations, according to *Internet Retailer's* annual rankings. Staples, Office Depot, Sears Holdings, Best Buy, J.C. Penney, Wal-Mart Stores, Circuit City and Target all made the top 20. All collect sales tax. **Limited Brand's** Victoria's Secret, which collects taxes, sold more online last year than did Overstock.com, which only applies tax to shipments bound for Utah.

In the early days, some bricks-and-mortar retailers, including Wal-Mart, set up their online operations as separate businesses and argued they didn't have to collect tax. But most later made deals with the states to begin collecting tax.

Non-traditional retailers have started moving into the tax line, too. Dell began collecting sales tax nationwide last year, prompting some grumbling online by surprised shoppers. CDW began collecting in 2005.

By collecting tax, retailers are freer to integrate their online, bricks-and-mortar and service operations. Customers, it turns out, like being able to return a defective DVD player purchased online to a local store.

But once a retailer offers hands-on services in a state, that state has a legal hook to demand its taxes be collected. Last year, for example, a California appeals court ruled that Borders Online owed the state sales taxes it failed to collect from 1998 to 1999 because customers could return online purchases to Borders' California stores.

Borders itself demonstrates the evolution of online selling. Since 2001, Borders has farmed out its online operations to Amazon.com. Amazon sells books under the Borders name, collecting taxes on sales shipped to just four states. Borders gets a percentage of the sales but Amazon handles the fulfillment and shipping.

In the first quarter of 2008, Borders plans to launch its own online site, ending its Amazon deal. Borders spokeswoman Anne Roman says that while the company still disagrees with the California court decision, its new online site will collect sales taxes nationwide. Why? It will have a clear physical presence in the states, with shoppers being given access in Borders stores to the online site. "We're integrating the online and in-store experience," Roman says.

Despite such developments, the states won't rest until Amazon itself caves. So the skirmishing continues. Last month, Illinois' attorney general won a state appeals court ruling that will allow the state to continue to pursue a lawsuit against a laundry list of online sellers, including Amazon.

Earlier this month, New York state's tax department issued a memo asserting that any in-state sales efforts by an independent agent for an online seller would make that seller liable to collect New York tax. Say a New York author links from his own Web page to his book's page on an e-commerce site and gets paid a commission for any sales the link brings in. According to this memo, the e-commerce site would be considered to be soliciting business in New York through the author and would have to collect taxes on all sales shipped to New York--not just sales of that one author's book.

The legally questionable memo prompted an outcry, and Democratic New York Gov. Eliot Spitzer ordered it withdrawn. Score one victory, at least temporarily, for tax-free shopping.