Maryland Remote Sales Tax Loss Study

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Introduction

Sales of tangible personal property made to Maryland consumers are generally subject to the State sales tax or, in those instances in which the seller does not collect the sales tax, they are subject to the use tax. The use tax is payable to the State directly by the purchaser. Supreme Court decisions have made clear that a state cannot compel remote sellers—those without a direct physical connection to the state—to act as an agent for that state and collect the sales tax. Accordingly, use tax is due on such sales. Ensuring compliance with the use tax is, for many reasons, exceedingly difficult. As a result, Maryland and all other states with a sales tax have foregone hundreds of millions of dollars of revenue from sales made by remote sellers. This issue has existed for decades with catalog, mail-order and telephone sales; the growth of foregone revenue has accelerated in recent years with the rapid expansion of electronic commerce (e-commerce).

Over the past ten years or so, the revenues lost to the states, and to Maryland, have been estimated by several parties. Initial estimates involving e-commerce were made at the turn of the century when the potential for substantial erosion of the sales tax base became clear, but before the course of e-commerce sales and developments in the market were known. Estimates of the revenue impact of remote sales—largely through expanding e-commerce—since that time have not been quite as dramatic, although all credible estimates continue to indicate a measurable reduction to sales tax revenues has occurred.

States have limited ability to recover this revenue which is due under current law. A comprehensive solution is beyond the reach of the states—congressional action is required. Some states have attempted to address the problem of remote sales at the margins, with limited degrees of success to date. Some have redefined the relationship between remote sellers and states, while others have attempted to make use tax compliance efforts more robust. Without legislation from Congress, these ongoing efforts of the states can reach only a fraction of the revenue lost to remote sales, even if they survive seemingly inevitable legal challenges.

Many states have addressed an overlapping issue, that of the taxation of digital goods. States are free to take action to recoup revenue losses occasioned by the market shift from books, CDs, DVDs, and software on physical media to digital goods purchased over the Internet if, in fact, the structures of their sales taxes are such that this market shift does result in a loss of revenue. In Maryland, existing law does not include digital goods in the sales tax base. The burgeoning market for digital goods is subject to the issue of remote sellers, but states can take action to make sales of such goods subject to the sales and use tax.

Remote Sellers and Nexus

Remote sales are conducted over the phone, through the mail, or on the Internet. The purchased good is generally shipped to the consumer via mail or common carrier, without an individual or business physically traveling to a storefront and purchasing a good. The ability of consumers and firms to buy goods without physically entering a store and the ability of the retailer to conduct business without the overhead of many retail locations can reduce transaction costs, which increases the attraction of remote sales relative to bricks-and-mortar sales.

E-commerce, enabled by the Internet, has greatly reduced other transaction costs by providing around-the-clock shopping opportunities, increasing the ease of gathering information such as product reviews and availability, and allowing easy price shopping. As a result, remote sale through e-commerce has grown dramatically as Internet connections, particularly broadband connections, have become more widespread. The growth in e-commerce has eroded states' sales tax bases, in part because of the inherent price advantage resulting from remote sellers' lack of nexus, a substantial physical presence in a state, which prevents states from mandating collection of the sales tax.

Maryland cannot require remote sellers making sales into the State to collect sales tax from Maryland consumers because, by definition, they lack nexus. The U.S. Supreme Court, in its 1967 decision in National Bellas Hess v. Department of Revenue of Illinois, established a bright-line test under which a retailer may be considered to have nexus in a state. In order to have nexus, the seller must have a substantial physical presence within a state by operating stores, owning property, or having employees or agents in the state. A remote seller whose only contacts with the state are through catalog solicitation, 800 phone numbers, and shipments of orders via common carrier—and now, through sales solicited or conducted through the Internet—lacks sufficient nexus in a state, and the seller can not be forced to collect taxes on sales made into the state. The National Bellas Hess decision was essentially reaffirmed by the Supreme Court's 1992 decision in Quill Corp. v. North Dakota.

Businesses with nexus in Maryland are legally required to collect sales tax at the point-of-sale and remit it to the State. Remote sellers are not and cannot be so compelled. For sales where the tax is not collected by the seller, the purchaser is legally required to remit an equivalent amount to the State in the form of use tax. Ensuring use tax remittances by individuals is much more costly to administer, leading to a much lower observed compliance rate. The disparity in the tax treatment of remote sales and bricks-and-mortar sales can result in a competitive advantage for remote sellers over local firms if the cost of shipping the good is less than the sales tax owed on the good.

Growth of E-Commerce

Technological innovation, the rapid expansion of internet infrastructure, and the continued development and maturation of online business markets have dramatically altered the landscape of how and where consumers purchase goods and services. E-commerce, the term commonly applied to sales through the Internet, has grown rapidly in recent years. The Census Bureau began publishing e-commerce statistics, based on survey data, in 1999. In 2009, e-commerce sales were estimated to have amounted to approximately $3.4 trillion, an increase from approximately $2.2 trillion in 2004, the earliest year with consistent data, an average growth rate of about 9% per year. Over the same period, total shipments, sales, and services are estimated to have increased from approximately $18.2 trillion to $20 trillion, annual growth of only 1.9%. As a result, e-commerce's share of total commercial activity increased from 12% in 2004 to approximately 17% in 2009.

The Census data reflects all commercial activity; the growth of e-commerce is even more notable when considering only retail sales, or final sales to consumers. In 2000, the Census Bureau estimated e-commerce retail sales were $27.8 billion, only 0.9% of total retail sales. By 2009, e-commerce retail sales had increased to $145.2 billion, annual growth of 20.2%, representing 4.0% of total retail sales. Growth was consistent between 2001 and 2007, at 20% to 30% annually, before dropping to low-single digit growth with the recession in 2008 and 2009.

As just one example of the very strong growth of retail e-commerce in recent years, Amazon had $2.4 billion of U.S. sales in 2000 according to its 10-K statements filed with the Securities and Exchange Commission. By 2010, Amazon's U.S. sales had increased to $18.7 billion, a staggering average annual increase of more than 23%. Over that period, total retail sales increased from $3.0 trillion to $3.9 trillion, average annual growth of only 2.7%. Another example is Dell Computers, whose U.S. sales grew 17% annually between 1999 and 2005, from $11.7 billion to $30.3 billion.

Separately but similarly, the proliferation of products that can be directly downloaded through the Internet and new hardware which has made these digital products more desirable and convenient has caused demand for digital products to grow exponentially. An example of new technology driving growth in digital sales is the growth of digital book sales. Since Amazon's Kindle was first released, e-book annual sales have increased from $31.7 million in 2007 to $441.3 million in 2010—individuals reportedly now purchase more e-books from Amazon than hardcover and paperback books. Another example of the growth of digital goods is Apple's iTunes store. According to Apple's 10-K statements, sales of "other music related products and services" (which includes iPod services and accessories as well as iTunes and now App Store and iBookstore sales) were $899 million in 2005. By 2010, sales had increased to $4.9 billion, annual growth of 41%. In 2011, sales grew an additional 28% to $6.3 billion. As digital goods are not currently taxable in Maryland, this expansion of the digital goods market, largely at the expense of sales of tangible personal property, is causing further erosion of the State's sales tax base.

Foregone Revenue Due to Remote Sales

The rapid growth of e-commerce coupled with the long-standing inability to tax remote sellers has resulted in an erosion of the State's sales tax base. Remote sales are generally broken down into two major types of transactions, business-to-consumer sales, in which a business sells a finished product directly to a consumer, and business-to-business sales, in which a business sells a finished good or an input product to another business. Furthermore, remote sales can be broken into two categories, remote sales that are performed electronically (e-commerce), and those that are performed non-electronically, through catalogs, telephone, and other means. In 2010, approximately 48% of business-to-consumer remote sales are estimated to have been e-commerce sales. The share of e-commerce business-to-consumer sales has steadily increased since the Census Bureau began reporting e-commerce statistics, and is expected to continue to do so.

In 2010, Maryland lost an estimated $198.4 million in sales and use tax revenue from the sale of tangible goods by remote sellers, which represents roughly 5.4% of gross sales tax collections. This estimate includes an estimated $97.2 million from e-commerce remote sales, and $101.2 million from non-electronic remote sales. The estimated revenue loss in 2010 for business-to-consumer sales is $164.5 million, while the loss from business-to-business sales is $33.9 million.

Estimated Foregone Sales Tax Revenue From Remote Sales ($ in millions)

	Electronic Remote Sales		Non-electronic Remote Sales		
CY	B2C	B2B	B2C	B2B	TOTAL
2010	79.1	18.1	85.4	15.7	198.4
2011	91.2	19.3	93.4	15.4	219.3
2012	100.9	20.5	98.2	15.1	234.8
2013	111.9	21.8	103.3	14.8	251.8
2014	120.2	23.0	105.4	14.5	263.1
2015	127.0	24.2	105.7	14.3	271.2
2016	133.6	25.4	105.6	14.1	278.7
2017	140.9	26.6	105.6	13.9	287.0
2018	148.0	27.7	105.2	13.9	294.8
2019	155.2	28.8	104.6	13.9	302.5
2020	162.8	29.8	104.0	14.0	310.5
2021	170.7	30.8	103.3	14.1	318.9
2022	178.9	31.8	102.4	14.3	327.4

Over the next ten years, this loss will continue to grow, although its growth will decelerate over this period. Growth in e-commerce is related to residential broadband internet access; as the percentage of households with broadband access gets increasingly close to 100%, the corresponding rate of growth in remote sales is expected to diminish from 7% or so in the first few years to under 3% in 2016 and later. As a result, revenue losses are estimated to total $327 million in 2022, average annual growth of 4.2% from 2010 to 2022. Losses due to e-commerce, however, will increase as a percentage of total losses from remote sales as buyers continue to shift towards e-commerce and away from other remote sales, rising from just under one-half of the total loss in 2010 to almost two-thirds by 2022.

Though the dollar value of business-to-business remote sales in any given year is much higher than for business-to-consumer remote sales, revenue losses from business-to-business remote sales are estimated to be much lower than business-to-consumer remote sales. Most business-to-business sales involve goods used as inputs for production, which are generally non-taxable under Maryland law. Additionally, businesses generally remit the use tax at a much greater rate than individual consumers. A 2010 study from the state of Washington estimates that businesses exhibited a 77% voluntary use tax compliance rate in 2006. These two factors dramatically reduce the amount of foregone revenues from business-to-business transactions relative to the total amount of activity. In contrast to sales to business purchasers, consumers have an extremely low use tax compliance rate. In addition, a much greater percentage of sales to consumers are taxable in Maryland. As a result, the amount of foregone revenue from remote business-to-consumer transactions is much larger relative to the total amount of business-to-consumer activity.

These estimates generally follow the methodology of several other studies that have addressed the issue of revenue foregone due to remote sales. The Census Bureau's remote sales data, non-electronic and retail e-commerce, was used as a starting point for estimating the revenues foregone from business-to-consumer sales. The Census data was shared to Maryland based on estimates of total retail sales. Some studies have allocated e-commerce sales based on sales taxes collected; the use of estimated retail sales results in a greater share of e-commerce retail sales allocated to Maryland.

Obviously, not all of these sales are from remote sellers; many of the largest online and catalog retailers have nexus in Maryland and do collect the sales tax. Furthermore, not all remote sales involved taxable goods. The Census e-commerce sales were first adjusted for these factors before allocating sales to Maryland. The Internet Retailer Top 500 list, which among other data reports the sales of the top 500 online retailers, was used to estimate the taxability of these sales. Simulated purchases of taxable goods were made from each of the top 50 firms, bottom 50, and 50 of the middle 400 selected at random to estimate the dollar volume of sales upon which tax was not collected by the seller (see Appendix I). These factors were used to estimate the revenue foregone from taxable remote sales in 2010. The 2010 estimate was used as a starting point for a forecast of foregone revenue. That forecast was based on total retail sales and Internet penetration in Maryland, which is correlated with the growth of retail e-commerce. Non-electronic business-to-consumer remote sales were forecast essentially as a residual, again relying on Census data as a starting point. As digital goods are included in Census data, foregone revenues related to digital goods were deducted from this estimate and are addressed below.

The methodology used to estimate business-to-business revenue losses is guided by prior studies; the primary data for this estimation is Maryland tax data as reported on sales tax returns. Use tax payments to Maryland in any given year are predominately attributable to business-to-business remote sales. This fact allows the use of use tax payments received by Maryland in 2010, coupled with the aforementioned estimate by the State of Washington on the rate of business-to-business use tax compliance, to form the base year estimate. Revenue losses are projected into future years using the average growth rate of Maryland's use tax payments from 2006 to 2010 and the trends in growth of business-to-business e-commerce as estimated by the Census Bureau.

This estimate of $198.4 million in foregone revenues in 2010 appears higher than that estimated in the frequently-cited 2009 University of Tennessee study by Professors Donald Bruce and William F. Fox, which estimated an impact of $139.3 million for Maryland. On a consistent basis, however, this estimate is, in fact, much lower than the Tennessee estimate. The $198.4 million estimate in this study includes not only foregone revenue from electronic remote sales ($97.2 million, the directly comparable figure), as the Tennessee study does, but also includes non-electronic remote sales ($101.2 million). The methodologies used by the studies are different, resulting in a different taxable base, rate of taxability of goods sold remotely, and voluntary compliance rate of sellers and buyers. In focusing solely on Maryland, rather than all states as the Tennessee study did, more specificity with respect to both retailers with nexus and taxability of goods sold was brought to bear. Finally, the present study uses a different method of forecasting the increase in remote sales and hence the foregone revenues.

Despite the differences in the studies, these and other current estimates of the revenue impact of e-commerce and remote sales are of roughly the same magnitude relative to sales tax collections. Over time, estimates of the revenue loss have declined as the explosive early growth of e-commerce has moderated, though to still very high rates. One of the seminal studies of this issue, by Bruce and Fox in 2001, estimated an effective revenue loss of $103 million for Maryland in 2001, rising to $355 million in 2006 and $430 million in 2011. A follow-up study, released in 2004, estimated a revenue loss of approximately $125 million in 2003 and $176 million to $266 million in 2008. And most recently, Bruce and Fox estimated a revenue loss of $139 million to $160 million in 2010, rising to $184 million to $204 million in 2012. The fact that the earlier studies estimated greater losses with a 5% sales tax rate while the most recent study estimates smaller losses under the current 6% sales tax rate amplifies the fact that previous forecasts of foregone revenues overstated the case.

There have been lower estimates of the revenue impact of e-commerce. A 2010 study by Jeffrey A. Eisenach and Robert E. Litan, of George Mason University and The Brookings Institution, estimated revenue losses of $69 million for Maryland in 2008 and $86 million in 2012. Given the uncertainties in the data, the extreme growth of e-commerce, necessary assumptions and estimates that factor into the bottom-line estimate, and more recently, the impact of the greatest economic slowdown since the Great Depression, the variance of these estimates is not surprising.

Foregone Revenue Due to the Non-Taxability of Digital Goods

The taxation of digital goods is a related issue, though distinct from the remote sales issue. Digital goods, including software, music, videos or other electronic files, are generally not taxable in Maryland so long as they are not sold on a tangible medium—in other words, if they are downloaded over the Internet. Maryland can choose to make the sale of digital goods taxable. If that were done, sellers would still have to have nexus with the State. Since digital goods are not currently subject to the Maryland sales and use tax, sales of digital goods do not lead to foregone revenues in the same sense as the remote sales of tangible goods. The most widely taxed digital good is downloaded computer software, taxed by 33 of 46 states (including the District of Columbia) with a sales tax. At least 24 states and the District of Columbia tax sales of digital books, music, movies or software (see Appendix II).

States Taxing Some or All Digital Goods

Alabama	Minnesota	Utah
Arizona	Mississippi	Vermont
Colorado	Nebraska	Washington
Conneticut	New Jersey	West Virginia
Hawaii	New Mexico	Wisconsin
Idaho	North Carolina	Wyoming
Kentucky	South Dakota	Washington, D.C.
Louisiana	Tennessee	
Maine	Texas	

Source: 2011 CCH Multistate Tax Guide

The Maryland market for digital goods is estimated to approach $200 million in 2013. Even if Maryland makes the purchase of digital goods taxable under the sales tax, revenues will not increase by 6% of that amount. Sales tax revenues could increase by an estimated $4.7 million in fiscal year 2013, as some large retailers of digital downloads do not have nexus and therefore cannot be required to collect the tax. Some large retailers of digital downloads do currently collect Maryland's sales tax on other transactions, and so apparently have nexus with Maryland. It is conceivable that, were sales of digital goods made taxable, these retailers could restructure their business so as to not have nexus and therefore avoid tax collection responsibilities, which would result in lower amounts of tax collected. That appears unlikely, however, as there presumably was a larger benefit to doing so in order to avoid all tax collection responsibilities and maintain a price advantage over those retailers with nexus.

Estimation of the size and future growth of the digital goods market, as well as the percent of sales which are attributable to firms whom have nexus, is largely based upon prior study by the states of Minnesota and Iowa. Unlike the case with e-commerce data, no source for data on aggregate digital goods sales has been identified. Many different data sources and growth estimates were used by these states and for this study, including the Association of American Publishers and the Recording Industry Association of America. Sales were then shared to Maryland based on population. Digital goods sales were forecasted with differing growth rates for different digital products. Finally, potential revenues from taxing digital goods were calculated after estimating market shares of digital goods retailers known to have a large presence in the market and determining whether those retailers currently collect the sales tax on sales of taxable goods.

Federal and State Responses to Remote Sales

In Quill, the Supreme Court stated that "the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve…. [Congress can] decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes" (502 U.S. 318 (1992)) because only Congress can regulate interstate commerce. Congress has considered such legislation several times in the intervening period, but has yet to take action.

One of the stronger objections to mandating remote sellers' collection of the sales tax is its complexity. There are almost five thousand state and local taxing jurisdictions, each potentially with different sets of definitions, tax rates, and administrative practices. In 1999, the Streamlined Sales and Use Tax was created by the National Governor's Association and the National Conference of State Legislatures to resolve the complexity issue. To date, 24 of the 44 sales tax states have passed conforming legislation to meet simplification and streamlining requirements. These requirements include:

- uniform tax definitions (e.g., what exactly constitutes food, which states may then choose to tax or exempt);
- uniform administration (e.g., a due date for remittances of the 21st of the following month and following the normal rules of rounding in determining the tax amount);
- rate simplification (e.g., one state tax rate, with very limited exceptions, and only one local rate for all jurisdictions in a state, whether the local rate is optional or mandatory); and
- uniform sourcing (which jurisdiction has the authority to levy the tax).

The purpose of the Streamlined Sales and Use Tax Agreement (SSUTA) is to convince Congress and retailers that the states' sales taxes can be administered in a manner that does not unduly burden interstate commerce, and thereby persuade Congress to enact legislation mandating the collection of the sales tax by remote sellers.

Federal legislation has been introduced multiple times in recent years to address the issue of remote sales. One of the two most recent iterations, the Main Street Fairness Act, was introduced in Congress on July 29, 2011. The Main Street Fairness Act only applies to states that have been approved for membership in the SSUTA. If this bill were to pass, all members of the SSUTA would have the authority to require online retailers to collect taxes in their state, even if those retailers don't have a physical presence in those states, as long as ten states comprising at least 20% of the population of states imposing a sales tax are member states under the agreement, which is currently the case—the twenty-four full members of the SSUTA represent 36.5% of the population of states imposing a sales tax, according to the 2010 Census.

The Main Street Fairness Act also requires the SSUTA to meet a lengthy list of simplification requirements to ease administrative burdens for sellers, although how the simplifications are determined and implemented is generally left up to the SSUTA. The Main Street Fairness Act does provide an exemption for small retailers, the definition of which is also left up to the SSUTA. The Main Street Fairness Act essentially codifies the substance and structure of the SSUTA.

On October 13, 2011, the Marketplace Equity Act of 2011 was introduced. This legislation would give all states the authority to require remote sellers with no presence in a state to collect sales tax from residents who buy their products. This bill would require states to simplify the process for out-of-state retailers, including providing a singles sales tax rate, designing a single form for remitting sales taxes arising from remote sales, and establishing uniform rules for what sales are taxable throughout the state with no distinction between exemptions for remote sellers and exemptions for other sellers. The Marketplace Equity Act also contains a small seller exception, but defines it as those with nationwide sales not exceeding $1,000,000, and in-state sales not exceeding $100,000, although states can increase those minimums.

The bill requires remote sellers to collect sales and use tax under one of three rate structures—a single state-wide blended rate that includes both the state rate and applicable rates of local jurisdictions, as determined by the state; the maximum state rate, which is the highest rate at which sellers are required by the state to collect tax, exclusive of any local tax; or the applicable destination rate, which is the sum of the state rate and any applicable rate for the local jurisdiction into which the sale was made. If the latter rate is required, the state must make available to remote sellers software that substantially eases the burden of collecting at multiple rates within the state. Any state providing such software must relieve remote sellers from liability to that state for collection for the incorrect amount of sales or use tax, including any penalties or interest, provided that collection of the improper amount is the result of relying on information provided by that state.

Because Congress has yet to enact legislation requiring remote sellers to collect sales taxes, many states have attempted to address the issue independently. One method is to enact legislation which specifically defines the terms "nexus" and "affiliate" such that out-of-state remote vendors may legally become taxable without themselves having nexus within a state. Another method that several states have used is to require remote sellers to report transactions with those states' residents, with the goal of minimizing use tax compliance costs.

New York enacted the first so-called "Amazon law," legislation that established nexus exists if a remote seller has certain business connections with an in-state affiliate. New York's legislation established a five percent threshold for all affiliate relationships: if the vendor selling through an affiliate into New York owns at least five percent of the affiliate, or vice versa, or if a third-party owns five percent or more of both of them, then the sales tax must be collected on the sale and remitted to the state. Crucially, New York also formed a connection between a remote seller and an in-state affiliate based on a shared logo, trademark, or common business branding, instead of through the affiliate's solicitation of the vendor's goods. Through this legislation, New York was legally able to tax certain remote sellers without violating current nexus restrictions. The Appellate Division of the New York Supreme Court recently upheld the law, although it has been remanded to the trial court.

California also enacted a law creating nexus through affiliates, effective July 1, 2011. In response, Amazon ended its affiliate relationships and undertook a campaign to repeal the law through a referendum. A short time later, a compromise was reached under which Amazon agreed to begin collecting sales tax on sales into California in September 2012, unless federal legislation addressing the taxation of remote sales is enacted before that point. Amazon has dropped its referendum push and invited its 10,000 affiliates back into the fold.

Rather than attempting to define nexus through affiliate relationships, Colorado enacted legislation in 2010 intended to improve enforcement of the use tax. The legislation required all vendors who do not collect the sales tax and who have over $100,000 of sales into Colorado in the prior calendar year to provide an annual report to the state listing all customers and purchases for the year. In addition, these remote sellers are obligated to notify their customers that the customers are required to remit use tax on their purchases. The state is expecting a revenue increase of approximately $12.5 million in fiscal year 2012, largely as a result of this reporting requirement. Such legislation has not been introduced in Maryland to date.

A number of other states have passed legislation similar to these two bills (see Appendix III). In the case of affiliate-nexus legislation, Amazon and Overstock.com, generally the largest companies affected, have terminated their relationships with all affiliates in those states, thus precluding the determination that nexus exists. In at least twelve states that have considered various means of addressing the revenue foregone from remote sales, Amazon has indicated that its affiliate relationships may end as a result of these pressures. Reportedly, over 200 companies including Overstock.com and Backcountry.com have terminated their affiliates in one or more states that have enacted affiliate-nexus laws. Amazon did not do so in New York, preferring to challenge the law instead. Use tax reporting legislation has been challenged in court by remote sellers, with the assistance of trade associations and civil liberties groups. Several of these challenges have been successful, though none have been finally determined. The constitutionality of these provisions, therefore, remains unsettled, and the likelihood of continued litigation appears high.

Possible Maryland Responses to the Erosion of the Sales Tax Base

The likelihood of Maryland recouping all of the revenues lost to remote sales is exceedingly low. As described above, congressional action is required for a comprehensive solution to this issue. While the prospects for passage of any legislation related to remote sales are unclear, it appears to be the case that the Marketplace Equity Act will result in the recapture of a larger portion of lost revenues than the Main Street Fairness Act, although the former has only recently been introduced and requires more thorough study.

The reason the Marketplace Equity Act will likely result in a larger revenue increase is because with one major exception, it generally leaves state sales taxes as they are, particularly for a state with Maryland with a relatively simple, straightforward sales tax. The small seller exception, if nothing else, does mean that some relatively small portion of the lost revenues would remain beyond Maryland's reach. More significantly, it is likely that the State's special 9% sales tax rate for alcohol would have to be repealed. Thus, for fiscal year 2013, revenues would increase by approximately $243 million, reduced by roughly $70 million for the alcohol sales tax and a modest amount for the small seller exception. The net revenue increase is estimated at $173 million—again, only if Congress adopts the Marketplace Equity Act.

The Main Street Fairness Act generally codifies the SSUTA. In 2009, the Comptroller's Office completed a study of the revenue effects of the SSUTA as it stood at the time. Full conformity, as would be required to enable Maryland to require remote sellers to collect the sales tax, was estimated to result in a likely revenue loss of $50 million, netted against the new revenues that would be collected, roughly $243 million for fiscal year 2013. There have been several modest adjustments to the SSUTA since that study was completed, but the major provisions that would affect Maryland revenues, including the rounding rule issue, remain in place. Further, this act also has a small seller exception, which would slightly reduce the net revenue increase available to Maryland under the act.

As with the Marketplace Equity Act, the recent adoption of a special sales tax for alcohol would likely have to be repealed to achieve conformity with the SSUTA, as states can generally have only one sales tax rate. Thus, if the Main Street Fairness Act were enacted, and Maryland conformed to the SSUTA, revenues would increase by approximately $243 in fiscal year 2013, less roughly $120 million for the changes to State law required for conformance, for a net revenue increase of approximately $123 million.

Without congressional action, Maryland could attempt to create nexus for remote sellers through affiliate relationships, which would only affect a subset of remote sellers. Maryland could also require remote sellers to report some or all transactions to the State, and to report use tax obligations to their customers in the State. Of course, such provisions would not be mutually exclusive.

Legislation was introduced in 2009 and 2010 in the General Assembly to require collection of sales and use taxes by a remote seller based on an affiliate relationship in the State. These bills aimed to form a connection between an out-of-state seller and an in-state representative through referrals to products sold by the seller. Out-of-state sellers would have been obligated to register for a sales and use tax license in Maryland if the amount sold through these referrals generated more than $10,000 in sales cumulatively in the preceding four quarters. The fiscal notes for the bills, developed from prior estimated revenue gains from several states, New York's experience with the collections through affiliates, and the Bruce and Fox studies, estimated an annual revenue increase of approximately $7.8 million and of $7.1 million for 2009 and 2010.

Based on 2010 sales data from the Internet Retailer's Top 500 list, not available for the fiscal notes for those bills, however, revenues could increase an estimated $21 million to $26 million annually if an affiliate-nexus bill were enacted in Maryland. This estimate is further supported by New York's actual collections from about 35 online retailers (remote sellers for New York). Approximately $100 million was collected in the state's fiscal year 2011. Adjusting for New York's 8.5% average state and local sales tax rate and Maryland's smaller population results in an estimate of $21 million. However, given that Amazon, the largest online retailer, has ended its affiliate relationships in most states with such provisions, there is no certainty of a substantial revenue increase under such a bill.

Bills requiring use tax reporting have not been introduced in Maryland. Colorado's legislation requiring remote sellers to notify their customers both that a use tax return is due and, by January 31 of each year, the total amount of goods bought from the retailer in the prior year. That information must also be filed with the Colorado Department of Revenue. The legislation, which remains under legal challenge, was expected to result in $12.5 million of use tax revenue. That estimate assumed a use tax compliance rate of 60%, applied to figures for Colorado from the Bruce and Fox (2009) study.

There are steps Maryland can take to both broaden and slow the erosion of its sales tax base with respect to digital and remote sales. Adding digital goods to the sales tax base would increase revenues by several million dollars, but Maryland still could not compel remote sellers of digital goods to collect the sales tax. Adoption of an affiliate-nexus law or a use tax reporting law could conceivably result in a revenue increase of several tens of millions of dollars, but available evidence indicates that the response of remote sellers would likely lead to extensive litigation with the State and very little additional revenue being collected. While over $240 million of currently due use taxes go uncollected each year, the prospects of Maryland receiving even a small percentage of that revenue are remote unless and until Congress decides to act.

Appendix I

Fifty Largest Online Retailers

North American Sales (Millions of Dollars)

Rank	Retailer	Retail Category	Online Sales	Collect MD Tax
1	Amazon.com Inc (US sales only, from 10-K)	Mass Merchant	18,703	N
2	Staples Inc.	Office Supplies	10,200	Y
3	Apple Inc.	Computers/Electronics	5,228	Y
4	Dell Inc	Computers/Electronics	4,802	Y
5	Office Depot Inc.	Office Supplies	4,100	Y
6	Walmart.com	Mass Merchant	4,095	Y
7	Sears Holding Corp.	Mass Merchant	3,107	Y
8	Liberty Media Corp. (QVC, Liberty E-commerce)	Mass Merchant	3,040	Y
9	OfficeMax	Office Supplies	2,859	Y
10	CDW Corp	Computers/Electronics	2,717	Y
11	Best Buy Co.	Computers/Electronics	2,500	Y
12	Newegg Inc.	Computers/Electronics	2,500	N
13	Netflix Inc.	Books / Music / Videos	2,160	N
14	SonyStyle.com	Computers/Electronics	1,955	Y
15	W.W. Grainger Inc.	Hardware / Home Improvement	1,800	Y
16	Costco Wholesale Corp.	Mass Merchant	1,700	Y
17	Macy's Inc.	Mass Merchant	1,605	Y
18	Victoria's Secret Direct & Bath and Body Works	Apparel / Accessories	1,563	Y
19	HP Home & Home office Store	Computers/Electronics	1,549	Y
20	J.C. Penney Co. Inc	Mass Merchant	1,530	Y
21	L.L. Bean Inc.	Apparel / Accessories	1,373	Y
22	Target Corp.	Mass Merchant	1,330	Y
23	Systemmax Inc.	Computers/Electronics	1,322	N
24	Gap Inc. Direct	Apparel / Accessories	1,266	Y
25	Williams - Sonoma Inc	Housewares / Home Furnishings	1,197	Y
26	HSN Inc.	Mass Merchant	1,175	N
27	Overstock.com Inc.	Mass Merchant	1,090	N
28	Amway Global	Health / Beauty	913	Y
29	Toys 'R' Us Inc	Toys / Hobbies	782	Y
30	Avon Products Inc	Health / Beauty	768	Y
31	Kohl's Corp	Mass Merchant	743	Y
32	Buy.com Inc	Mass Merchant	741	N
33	Redcats USA	Apparel / Accessories	717	N
34	Nordstrom Inc.	Apparel / Accessories	705	Y
35	Symantec Corp.	Computers/Electronics	675	N
36	Vistaprint Ltd.	Office Supplies	670	N
37	PC Connection Inc.	Computers/Electronics	606	Y
38	Saks Direct	Apparel / Accessories	585	Y
39	Neiman Marcus Group Inc., The	Apparel / Accessories	574	Y
40	Cabela's Inc	Sporting Goods	574	Y
41	BarnesandNoble.com Inc	Books / Music / Videos	573	Y
42	Blockbuster Inc.	Books / Music / Videos	569	Y
43	Home Depot Inc., The	Hardware / Home Improvement	550	Y
44	Musician's Friend Inc.	Specialty / Non-apparel	546	N
45	1-800- Flowers.com Inc	Flowers / Gifts	470	N
46	drugstore.com Inc	Health / Beauty	457	Y
47	Peapod LLC	Food / Drug	451	Y
48	Urban Outfitters Inc.	Apparel / Accessories	434	Y
49	Gilt Groupe	Apparel / Accessories	425	N
50	J.Crew Group Inc.	Apparel / Accessories	397	Y

Source: Top 500 Internet Retailers

Appendix II
Selected States' Taxation of Digital Goods

New Jersey
Effective October 1, 2006, the sales tax is imposed on sales of "digital property." New Jersey defines digital property as the following types of property, when delivered through electronic means: music, ringtones, movies, and books, audio and video works from similar products.

Digital property may be received on various types of electronic equipment, for example computers, cellular telephones, or devices that store, organize and play audio or video files. The products identified as digital property are also subject to sales tax when delivered in tangible form.

New Jersey imposes the tax on receipts from the sale of the digital property listed above. It is not imposed on other types of property that are delivered electronically, such as digital photographs, digital magazines, etc.

South Dakota
In 2008 South Dakota's legislature passed a bill that imposes the sales tax on all sales, leases and rentals of any products transferred electronically. In addition, the sale of a digital code that may be utilized to obtain a product transferred electronically shall be taxed in the same manner as the product transferred electronically.

Utah
Utah imposes its sales tax on all products that are transferred electronically only if those products would be subject to tax if transferred in a manner other than electronically.

Vermont
Enacted in 2009, Vermont taxes three defined types of digital products: digital audio-visual works, digital audio works, and digital books in addition to ringtones.

Washington
In Washington the term "digital goods" is defined to include the three specifically defined digital products in the SSUTA as well as other sounds, images, data, facts or information that is transferred electronically. The state specifically exempts certain products and services, including personal or professional services, when the results of the work are delivered electronically, various digital goods purchased solely for business purposes, electronic public records, and certain newspapers delivered electronically.

Washington also imposes its sales and use tax on digital automated services such as photo sharing services, car history report services, information services and search engines for which there is a charge. The legislation also specifically taxes remote access software, which is prewritten software provided remotely when the buyer pays the seller for the right to access and use the software which resides on the seller's server or the server of a third party.

Wyoming

Effective July 1, 2010 Wyoming explicitly subjects specified digital products, such as music, movies and books to the state's sales tax if the purchaser has permanent use, possession or control of the product. This bill was estimated to have no significant fiscal impact on the state of Wyoming as specified digital products were already taxed as tangible personal property.

Appendix III
State Actions Addressing Foregone Sales Tax Collections

Expanded Nexus Statutes

California

Effective July 1, 2011, California passed affiliate nexus tax legislation requiring out of state retailers to collect sales tax on purchases made over the Internet by their California click-through customers. Retailers engaged in business in the state were defined to include any retailer entering into an agreement under which a person in California, for a commission or other consideration, refers potential purchasers of tangible personal property to the retailer, whether by an Internet-based link or an Internet website or otherwise, provided that both of these conditions are met: (1) the retailer's total sales of tangible personal property to California consumers that are referred pursuant to such agreements with persons in California in the past 12 months exceed $10,000; and (2) the retailer's total sales of tangible personal property to California consumers in the past 12 months exceed $500,000. In response to the California legislation, Amazon notified its 10,000 California marketing affiliates that they will stop paying commissions for referrals to California customers.

On September 23, 2011 California's Governor, Edmund Brown, signed a bill that requires Amazon and other internet retailers to collect sales taxes starting in 2012. This bill, a compromise between the state of California and Amazon, delayed the sales tax collection obligations for remote sellers with affiliates in the state that were enacted July 1, 2011. The new legislation gives online companies time to seek an alternative national solution to the issue of foregone revenues as a result of remote sales. In exchange for California's support and the extension of the start date, Amazon will drop its referendum challenge to the prior legislation. Amazon has also pledged to create at least 10,000 full-time jobs and hire 25,000 seasonal employees in California by the end of 2015, generating an estimated half billion dollars of capital investment in California.

Recent legislation also expands California's use tax registration requirements to large out of state retailers that were previously not required to collect the use tax on sales through mail order, telephone order, or the Internet to California customers. The legislation provides that a retailer engaged in business in the state includes any retailers that is part of a commonly controlled group and is a member of a combined reporting group that includes another member of the retailer's commonly controlled group that, pursuant to an agreement with or in cooperation with the retailer, performs services in California in connection with tangible personal property to be sold by the retailers.

New York

New York has enacted a law requiring online retailers, like Amazon, to collect state sales tax where the online retailer has commissioned affiliates located in the state who maintained websites with links to the online retailer. This statute has become known as the "Amazon Law." Amazon and Overstock.com sued New York's Department of Taxation challenging the constitutionality of this law. While the New York court held that the Amazon Law was constitutional as written, it sent the case back to the trial court to develop a factual record before addressing the conduct of the business. New York has collected over $170 million in revenue from about 35 online retailers since enactment of the law.

Arkansas

In April 2011, Arkansas passed a law imposing tax collection responsibilities on Internet retailers with Arkansas affiliates and more than $10,000 a year in sales to state residents. The law went into effect 90 days after it was passed.

Rhode Island

Effective July 1, 2009, Rhode Island's General Assembly enacted a law to provide a presumption that certain sellers of taxable tangible personal property are retailers, as defined by the state, and are required to register, collect and remit sales tax to the state. The amended definition includes businesses located outside of Rhode Island soliciting sales of taxable tangible personal property or services through employees, sales persons, independent contractors, agents, or other representatives located in Rhode Island.

Under the new legislation, an e-commerce retailer that uses persons to act as its representatives in the State to solicit sales or to make and maintain a market in return for commissions, referral fees or other types of compensation is considered to be soliciting businesses within the state through the use of independent contractors or representatives. Therefore, the e-commerce retailer must register as a retailer for Rhode Island sales tax purposes.

In order to satisfy the expanded definition, the cumulative gross receipts from sales by the seller to customers in Rhode Island must total more than $5,000 during the preceding four quarterly sales tax periods in order to be required to collect sales tax on its taxable sales in Rhode Island.

Illinois

In March of 2011, Governor Quinn signed legislation that requires Internet retailers like Amazon to collect Illinois' sales tax if they have affiliate sellers in the state. Effective July 1, 2011, certain remote vendors and service provides who have commission arrangements with in-state parties will be deemed to have nexus with the state for purposes of collecting the state's sales and use tax. In response to the passage of this bill, Amazon and Overstock.com terminated their Illinois affiliates, thereby severing nexus with the state.

Use Tax Reporting Statutes

Colorado

While refraining from requiring out-of-state retailers to collect and remit state sales and use tax, Colorado enacted a law subjecting out-of-state retailers to extensive information-reporting requirements. Each retailer that does not collect Colorado sales tax is required to notify Colorado purchasers that sales or use tax is due on certain purchases made from the retailer and that the state of Colorado requires the purchaser to file a sales or use tax return. The information that is required, if available, is the dates of purchase, amounts of each purchase, and the category of the purchase, including whether the purchase is tax-exempt or not, if known by the retailer. The notification must state that the Colorado requires a sales or use tax return to be filed and sales or use tax paid on certain Colorado purchases made by the purchaser from the retailer. In May of 2011 Colorado's House voted to repeal the information reporting requirements and replace them with a single requirement that the retailers provide Colorado purchasers with post-purchase notification that they may be subject to Colorado use tax on their purchases. The notification must provide a link to the Department of Revenue's website, where the purchasers could obtain more information about their tax obligations.

North Carolina

The North Carolina Department of Revenue (NCDOR) issued a request to Amazon for the purchase records of customers with a North Carolina shipping address from August 2003 through February 2010 as part of a tax audit of Amazon. Amazon complied, providing the product codes that reveal the exact items purchased by North Carolina residents, but withheld individually identifiable user information, including names and addresses, that could be linked back with specific purchases. NCDOR refused to agree that it was not entitled to such information, which led to a lawsuit by Amazon. In June of 2010, the American Civil Liberties Union intervened, maintaining that requests by NCDOR for detailed information about Amazon customers are unconstitutional because they violate Internet users' rights to free speech, anonymity and privacy.

In Amazon.com vs. Lay, a federal court found the authority to review actions by a state agency and applied federal law to tax collection activity. The federal trial court considered whether the First Amendment and federal statues barred NCDOR from demanding that Amazon provide customer names after Amazon had already provided to NCDOR the titles of books and movies purchased by North Carolina residents. The federal court ruled that the First Amendment and federal Video Privacy Protection Act prevented NCDOR from obtaining customer names and titles of purchases at the same time. Amazon has terminated all of its affiliates in North Carolina.

Oklahoma

Similar to legislation passed in Colorado, Oklahoma passed a measure in 2010 requiring out-of-state retailers to provide notice on its website and sales confirmation that Oklahoma purchasers still have to pay use taxes on out-of-state purchases. The measure further prohibits retailers from advertising on their retail Internet website or retail catalog that there is no tax due on purchases made from the retailer for use in the state.

South Dakota

Senate Bill 146 was signed into law on March 11, 2011. Similar to a model that has been previously adopted in Colorado and Oklahoma, Senate Bill 146 focuses on information reporting. The bill imposes a transaction notice requirement on retailers who are not currently registered with the state who are not required to collect sales tax and who make sales of tangible personal property, services, or products transferred electronically to purchasers in the state. The notice is to be readily visible and contain the following information: that the retailer is not required to and does not collect South Dakota sales or use tax; that the purchase is subject to state use tax unless it is specifically exempt from taxation; that the purchase is not exempt merely because the purchase is made over the Internet, by catalog of by other remote means; that the state requires each South Dakota purchaser to report any purchase that was not taxed and pay tax on the purchase by remitting the state use tax form; and that the use tax form and corresponding instructions are available on the South Dakota Department of Revenue and Regulation website.

While requiring the above-referenced transactional notice, this bill does not require an annual statement to customers or an annual report to the state. It also expressly prohibits the application of criminal penalty or civil liability for failure to comply with the provisions of the new law.