Statement of Estimated State and Local Revenue Impact

Date: March 17, 2014

Bill Number: S. 870

Author: Kimpson

Committee Requesting Impact: Senate Finance

Bill Summary

TO AMEND THE CODE OF LAWS OF SOUTH CAROLINA, 1976, BY ADDING SECTION 12-36-71 SO AS TO PROVIDE THAT A RETAILER IS PRESUMED TO BE LIABLE FOR THE SALES TAX OR RESPONSIBLE FOR COLLECTING AND REMITTING THE USE TAX IF THE RETAILER ENTERS INTO AN AGREEMENT WITH A RESIDENT OF THIS STATE UNDER WHICH THE RESIDENT, FOR CONSIDERATION, REFERS POTENTIAL CUSTOMERS, WHETHER BY AN INTERNET LINK OR OTHERWISE, TO REQUIRE SUCH RETAILERS TO OBTAIN A RETAIL LICENSE AND REMIT SALES AND USE TAX ON ALL TAXABLE RETAIL SALES, AND TO PROVIDE EXCEPTIONS.

REVENUE IMPACT [1/]

While this bill provides additional reporting and enforcement tools applicable to a subset of remote retailers, based on the mixed success experienced in other states to similar enacted click-through legislation, we do not anticipate that South Carolina will realize any appreciable increase in sales and use tax revenue from the enactment of this bill in FY 2014-15.

Explanation

This bill addresses one aspect of the tax compliance and enforcement issues regarding E-commerce sales. In particular, this bill imposes an obligation to collect sales and use tax on an out-of-state retailer that enters into an agreement with a resident of this state who, for a commission or other consideration, directly or indirectly refers potential customers, by internet link or otherwise, to the out-of-state retailer. For clarification, other aspects of this issue include remote retailers without affiliate programs and Commerce Clause limitations that require remote retailers to have a substantial physical presence before states may require collection of sales and use tax.

Pursuant to this bill, the obligation to collect sale and use tax applies only if the out-of-state retailer's gross proceeds from the in-state referral agreements exceed $10,000 in the preceding twelve months. The presumed obligation can be rebutted by proof that the referring South Carolina resident did not engage in any solicitation in South Carolina on behalf of the out-of-state retailer during the preceding twelve months that would satisfy the nexus requirement of the United States Constitution.

Out-of-state retailers obligated to collect and remit sales and use tax under this provision must obtain a retail license and remit state and local sales taxes in accordance with the sales tax statutes.

A retailer that owns, leases, or utilizes a distribution facility in this state pursuant to §12-36-2691 is not obligated to collection and remit sales and use tax under these provisions of this bill.

The potential amount of sales tax revenue from remote sellers is significant. Staff of the Board of Economic Advisors recently updated our estimated revenue gains for FY 2014-15 on legislation requiring remote sellers to collect sales and use tax on sales sourced in South Carolina if the Congress of the United States enacts legislation granting this authority. We estimate, after accounting for items exempted from South Carolina sales tax, that total taxable E-Commerce retail and wholesale sales in South Carolina for FY 2014-15 will total $5.1 billion. These sales would potentially produce $366.6 million in sales tax revenue at the combined average state and local rate of 7.2%. The average tax rate estimate is due to the optional aspect of the local sales taxes and is based on the amount of sales taxes collected by ZIP codes weighted by population. Of the total $366.6 million, we estimate that retailers, businesses, and individuals will remit $274.8 million in sales and use tax revenue to South Carolina on E-commerce retail and wholesale transactions in FY 2014-15. The remaining uncollected sales and use taxes are expected to total $91.8 million statewide in FY 2014-15. Please note that collecting this potential sales tax revenue is predicated on the passage of federal law obligating remote retailer to collect the tax from consumers at the time of the retail sale.

Nexus issues with remote out-of-state retailers existed before South Carolina imposed a sales and use tax in 1951. Remote sellers have made sales to customers without a physical presence in the state since at least 1872 when Montgomery Ward issued its first mail order catalog. This bill would presume sales tax nexus in the situation where a remote seller has no physical presence in South Carolina but pays commissions or some other consideration for referrals from a South Carolina resident or business. These referrals can be by internet link on the South Carolina resident or business' website or otherwise. Currently, the out-of-state retailer with no physical presence in South Carolina is not obligated to collect sales tax on purchases by South Carolina residents and businesses. The South Carolina residents and businesses are legally responsible for remitting the state and local taxes, but voluntary compliance, especially for individuals, is low. Businesses, due to sales tax and income tax audits, are more likely to remit the use tax on out-of-state purchases from remote retailers.

The revenue impact of S.870 depends on the behavioral changes that could occur if this bill were enacted. South Carolina's likelihood of increased sales and use tax collections is reliant on internet retailers' willingness to continue their referral arrangements with South Carolina residents and businesses. The remote sellers would also have to begin to comply with the added sales tax collection obligations imposed by South Carolina sales tax statutes.

When similar click-through legislation was passed in other states, most large internet retailers terminated their affiliate referral programs. For example, Overstock.com terminated its affiliate program in New York and most other states that have passed this type of legislation. Amazon terminated its associate programs in Arkansas, California (reinstated), Colorado, Connecticut, Illinois, Maine, Missouri, New Mexico, North Carolina, and Rhode Island. Performance Marketing sued the state of Illinois when their law was passed in 2011. Performance Marketing, an advocacy association for affiliate marketers, estimated that of the 9,000 Illinois affiliates with 2010 advertising revenue, 6,000 moved out of state or went out of business, and the remaining 3,000 were downsized by the Illinois statute. The Illinois Supreme Court struck down their click-through statute in October 2013.

Additional states have reported a lack of success in raising revenue. Connecticut Revenue Commissioner Kevin Sullivan said "We have not seen any appreciable or demonstrable relationship between the legislation and entities collecting and remitting taxes that were not collecting and remitting before."[1] Officials at the Rhode Island Department of Revenue "do not believe that there has been any sales tax collected as a result of the Amazon legislation," said Paul L. Dion, who heads the department's revenue-analysis office.[2] The District of Columbia's Commission that reviewed its major taxes and considered ways to improve their tax system looked at expanding the definition of nexus to require online retailers with District-based affiliates to collect the District sales tax. The Commission did not recommend this action and found "Most states that have created such laws have not seen new tax revenue. That is because businesses in those states opt to end commission-based relationships rather than collect the tax. In fact, ORA estimated the revenue increase from passage of such a tax in the District is likely negligible."[3]

In contrast, New York and California are two states that report substantial revenue from the enactment of the click-through legislation and other measures. We do not anticipate similar additional revenues in South Carolina for the following reasons. These two states represent the largest markets for electronic and mail order retailers in the United States. Even adjusted on a per capita basis, they both report over four times more electronic and mail order sales per person relative to South Carolina. Given the expansive markets these states, remote retailers did not terminate their affiliates in New York and California as in most other states. In particular, Amazon, the largest on-line retailer by far, retained their affiliates in both of these states. In addition, California is the state of residence for e-Bay which would also tend to overstate any revenue comparisons with South Carolina. These states also enacted additional measures to enhance nexus including amnesty programs that reduced or eliminated previous tax, penalty and interest for remote retailers that volunteered to register with the states and begin to collect and remit the sales tax. Given that South Carolina's remote sales are so much smaller compared to New York and California, in magnitude and on a per capita basis, we expect that remote retailers will largely terminate their affiliate programs much like their reaction to similar legislation enacted in other states. This expected reaction by the remote retailers' will limit any expected revenue increase from the additional reporting and enforcement tools provided in this bill.

The most recent federal legislation that would establish nexus on all remote sellers is the Marketplace Fairness Act of 2013. This legislation has passed the United States Senate and is pending in the House. This legislation would require South Carolina to adopt simplification requirements and allow a $1 million small retailer threshold exemption. We estimate that the revenue impact would be reduced by 6% from the $91.8 million above, to $86.3 million, due to a $1 million small retailer threshold exemption in the current version of the Marketplace Fairness Act. Of the $86.3 million total, $47.95 would be credited to the General Fund and $12.8 million each would be credited to the EIA and the Homestead Exemption Funds. Local

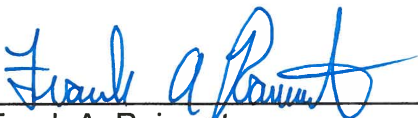
---

1 Henchman, Joseph, Connecticut Revenue Commissioner Admits the "Amazon" Tax Has Raised Zero Revenue, Tax Foundation Blog, November 26, 2012.
2 Nesi, Ted, "Amazon tax" has not generated revenue, Providence Business News, December 21, 2009.
3 DC Tax Revision Commission Recommendations, February 12, 2014.

governments would receive a total of $15.3 million spread among the various local sales and use taxes currently imposed.

Federal legislation like the Marketplace Fairness Act would overcome the major hurdle that South Carolina faces in imposing sales and use tax on out-of-state retailers with no physical presence in the state. The U.S. Supreme Court's 1992 decision in *Quill Corp. v. North Dakota*, found that a state cannot compel a remote retailer to collect sales tax unless some type of physical presence, or nexus, exists in the state. Since the 1992 Quill decision, over 20 states have enacted some type of legislation to chip away at the nexus problem by broadening the list of activities that can create nexus. In effect, S.870 mirrors New York's click-through nexus law enacted in 2008 and subsequently enacted in 13 other states. The remaining seven states enacted what is generally referred to as affiliate nexus provisions. These statutes presume nexus if a remote seller is related to, a subsidiary of, or part of a corporate group with the in-state entity. These affiliate nexus provisions extend nexus to the internet subsidiary of a traditional brick and mortar retailer.

In summary, this bill provides additional reporting and enforcement tools applicable to a subset of remote retailers. However, based on the mixed success experienced in other states to similar enacted click-through legislation, we do not anticipate that South Carolina will realize any appreciable increase in sales and use tax revenue from the enactment of this bill in FY 2014-15.



Frank A. Rainwater
Chief Economist

Analyst: Shuford

[1/] This statement meets the requirement of Section 2-7-71 for a state revenue impact by the BEA, or Section 2-7-76 for a local revenue impact, or Section 6-1-85(B) for an estimate of the shift in local property tax incidence by the Office of Economic Research.