



Arizona State Senate Issue Brief

October 29, 2008

Note to Reader:

The Senate Research Staff provides nonpartisan, objective legislative research, policy analysis and related assistance to the members of the Arizona State Senate. The *Research Briefs* series, which includes the *Issue Brief*, *Background Brief* and *Issue Paper*, is intended to introduce a reader to various legislatively related issues and provide useful resources to assist the reader in learning more on a given topic. Because of frequent legislative and executive activity, topics may undergo frequent changes. Additionally, nothing in the *Brief* should be used to draw conclusions on the legality of an issue.

INTERNET TAXATION

INTRODUCTION

In 1998, Congress passed the Internet Tax Freedom Act (Act). The Act imposed a three-year prohibition, until October 21, 2001, on the imposition of state or local taxes on Internet access fees. The Act has a limited grandfather clause for some states that were already taxing Internet access when the law became effective. The Act also prohibits state or local governments from imposing taxes that would subject buyers and sellers of e-commerce to taxation in multiple states.

States were already prohibited by the U.S. Constitution's Commerce Clause and Supreme Court decisions from imposing sales taxes on retailers that have no physical nexus. Nexus refers to a seller's minimum level of physical presence within a state that permits the taxing authority to require the seller to register, collect and remit sales/use tax and comply with the state's taxing statutes and regulations. This is what prevents states from requiring mail-order retailers to collect taxes on most catalog sales; this logic applies equally to e-commerce retailers. For example, the State of Arizona cannot require an online or mail-order retailer located in another state to collect taxes on sales to Arizona residents if the retailer does not have a physical presence in Arizona. However, this prohibition could be lifted by Congress.

A temporary Advisory Commission on Electronic Commerce was also established by the Act to study e-commerce tax issues and report back to Congress after 18 months on whether electronic commerce should be taxed and how. Additionally, Congress mandated that there should be no federal taxes on Internet access or e-commerce during the effective period of the Act. The Commission reported its findings to Congress in 2000 and made the following recommendations:

- substantially reduce the overall burden on consumers due to state and local sales taxes by radically simplifying state and local tax systems and reducing the aggregate collection costs of all transactions, which will allow all sellers to pass on those cost savings to taxpayers.
- create a simple and equitable system for state and local sales taxes that would impose equal obligations and costs on all

sellers, local or remote, regardless of sales channel or technology utilized.

- address concerns regarding the digital divide and the regressive character of state and local transaction taxes by eliminating the disparate tax treatment of main street and Internet sales, banning taxes on Internet access and reducing overall transaction tax rates.
- eliminate the federal excise tax on communications services, simplify state and local telecommunications taxes and eliminate multiple and discriminatory taxation of telecommunication services and property.
- protect the privacy of consumers by minimizing the disclosure of personal information for tax collection purposes.

The Internet Tax Nondiscrimination Act of 2004 extended the moratorium through 2007.

ARIZONA TAX IMPLICATIONS

The Arizona Department of Revenue has conducted studies on issues related to the Internet and has determined that Internet access charges would not be subject to transaction privilege taxation (TPT) under Arizona law, nor are they subject to tax as a telecommunications service. *Additionally, sales of goods over the Internet are treated the same as sales of tangible personal property through more traditional channels and, therefore, are subject to the rules of nexus and Arizona's TPT/use tax laws.* However, information or software purchased via downloading from the Internet is subject to the Arizona privilege/compensating use tax. In terms of who is responsible for reporting the tax to the state, if a seller has nexus within the state, the seller is required to collect and remit the compensating use tax to the state. If the seller does not have nexus, the consumer by law should self-assess and remit the use tax directly to the state.

In 2008, Arizona enacted legislation to exempt Internet application services that are designed to assess or test student learning or to promote curriculum design or enhancement, which are purchased by or for any school

district, charter school, community college or state university from the retail classification of TPT, rental property and use tax.

STREAMLINED SALES TAX

Streamlined sales tax is a nationwide, multistate effort to simplify and modernize sales and use tax collection and administration. Proposals have included tax law simplifications, more efficient administrative procedures and emerging technologies.

Key features of streamlined sales tax are:

- uniform definitions within tax laws.
- rate simplification.
- state level tax administration of all state and local sales and use taxes.
- uniform sourcing rules.
- simplified exemption administration for use- and entity-based exemptions.
- uniform audit procedures.
- state funding of the system.

In January of 2000, the National Conference of State Legislatures' Task Force on State and Local Taxation of Telecommunications and Electronic Commerce drafted model legislation directing revenue department officials to engage in multistate discussions on ways for states to collectively streamline and simplify their sales and use tax systems. The goal was to reduce the burden of collection for all sellers and create a voluntary collection system for remote sellers with no requirement to collect and remit state sales taxes.

In 2000, 32 states, including Arizona, officially joined what became known as the Streamlined Sales Tax Project (SSTP) through legislative enactment of the model bill or executive order. The SSTP met monthly throughout 2000 and produced a set of recommendations for terms of a Streamlined Sales Tax and Use Tax Interstate Agreement (IA) to achieve the aforementioned goals. To date, 13 states are in full compliance with the IA and 7 additional states are associate members in the SSTP and will achieve full compliance after January 1, 2008. Arizona has not introduced

legislation to implement the goals of the SSTP and IA.

The idea is for all states to change their sales and use tax laws to conform with the simplifications as proposed by the SSTP. Thus, the simplifications would apply to all sellers. Sellers who do not have a physical presence or “nexus” are not required to collect sales and use taxes unless Congress chooses to require collection from all sellers for all types of commerce. Sellers without a physical presence can volunteer to collect under the proposed simplifications.

The SSTP envisions two components to the legislation necessary to accomplish streamlined sales tax goals. First, states would adopt enabling legislation referred to as the Uniform Sales and Use Tax Administration Act. Second, states would amend or modify their sales and use tax laws to achieve the simplifications and uniformity.

• **ADDITIONAL RESOURCES** •

- Arizona Department of Revenue
www.azdor.gov
- Sales Taxes and the E-Commerce Revolution
<http://www.gppf.org>
- Advisory Commission on Electronic Commerce
http://www.ecommercecommission.org/acec_report.pdf
- The Streamlined Sales Tax Project
www.streamlinedsalestax.org
- National Conference of State Legislatures
www.ncsl.org
- Tax Reform for Arizona Citizens Committee, Final Report, December 2003