

SUBJECT: Requiring retailers engaged in business in Texas to collect sales taxes

COMMITTEE: Ways and Means — committee substitute recommended

VOTE: 8 ayes — Hilderbran, Otto, Elkins, Gonzalez, Martinez Fischer, Murphy, Ritter, Woolley

0 nays

3 absent — Christian, Lyne, Villarreal

WITNESSES: For —Ronnie Volkening, Texas Retailers Association; Wayne Zakrzewski, J. C. Penny, Inc.; John Raney; (*Registered, but did not testify*: Portia Bosse, Texas State Teachers Association; Luke Cutchen, Allen Kirsh, Musicians Austin; Kellie Duhr, Wal-Mart Stores, Inc.; Randy Erben, The Home Depot; Shanna Igo, Texas Municipal League; William Johnson, The Neiman Marcus Group, Inc.; John Kennedy, Texas Taxpayers & Research Association; Dick Lavine, Center for Public Policy Priorities; Ted Melina Raab, Texas AFT; Karen Reagan, Walgreen Co.; Mark Vane, Gardere Wynne Sewell; Amanda Vining, Texans Care for Children; Thomas Wolfe, Texas Conservative Coalition; Steven Bercu; Gregg Burger; David Kruger)

Against — (*Registered, but did not testify*: Kelly Cobb, Americans for Tax Reform; Luis Saenz, Amazon; Geoff Wurzel, TechNet)

On — Jeffrey Clark, Technology Association of America (TechAmerica); John Eliason, Gardere Wynne Sewell; (*Registered, but did not testify*: Rebecca Madigan, Performance Marketing Association)

BACKGROUND: Tax Code, sec. 151.103 requires a retailer who engages in business in Texas and who sells a taxable item for storage, use, or consumption in Texas to collect, on behalf of the state, applicable sales taxes due from the purchaser.

Tax Code, sec. 151.107 defines a retailer who engages in business in Texas as one that:

- maintains, occupies, or uses in Texas, directly or through an agent, an office, place of distribution, sales or sample room or place, warehouse, storage place, or any other place of business;
- has a salesman, representative, or agent operating in Texas to sell or deliver or take orders for a taxable item;
- derives rentals from a lease of tangible personal property in Texas;
- engages in regular solicitation of sales of taxable items;
- has a franchisee or licensee operating under its trade name if the franchisee or licensee is required to collect sales tax;
- engages in interstate commerce in Texas that, under federal law, is made subject to the state's taxing jurisdiction;
- advertises in Texas; or
- otherwise does business in Texas.

Tax Code, sec. 151.008(b) defines a seller or retailer as:

- a person or business that makes sales at auction;
- a person or business that makes more than two taxable sales in a 12-month period;
- a person deemed by the comptroller to be a seller or retailer;
- a hotel or motel;
- an owner or lessor of an office or residential building or development that pays for telecommunications services for resale to guests or tenants; or
- a person who engages in regular solicitation of sales of taxable items.

DIGEST:

CSHB 2403 would expand the definition of a retailer engaged in business in Texas to include a retailer holding a substantial ownership interest in, or owned by, an entity with a location in Texas from which business was conducted if:

- the retailer sold the same or a substantially similar line of products as the person with the location in Texas and sold those products under a business name that was the same or substantially similar to the business name of the person with the location in Texas; or

- the facilities or employees of the person with the location in Texas were used to advertise, promote, or facilitate sales by the retailer to consumers or perform any other activity on behalf of the retailer intended to establish or maintain a marketplace for the retailer in Texas, including receiving or exchanging merchandise.

The definition also would include an entity holding a substantial ownership interest in another entity that had a distribution center, warehouse, or similar location in Texas and delivered property sold by the retailer to consumers.

CSHB 2403 would expand the definition of a seller or retailer to include a person or business who, under an agreement with another person, was:

- entrusted with possession of tangible personal property with respect to which the other person had title or another ownership interest; and
- authorized to sell, lease, or rent the property without additional action by the person having title to or another ownership interest in the property.

The bill would define “ownership” as direct, common, or indirect ownership through a parent entity, subsidiary, or affiliate.

“Substantial” would mean an ownership interest of at least 50 percent.

The bill would take effect January 1, 2012, and would only affect tax liability that accrued on or after that date.

**SUPPORTERS
SAY:**

CSHB 2403 would clarify existing law requiring businesses that have a physical presence in Texas to collect sales tax on their sales to Texas customers. Currently, some businesses that sell to Texas customers attempt to skirt the statutory definition of doing business in Texas through creative corporate and ownership structures, in which certain business aspects are fulfilled by companies present in Texas while the taxable sales are performed by related out-of-state companies.

Texas only may require those businesses with a physical presence in the state to collect sales taxes. In *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the U.S. Supreme Court prohibited states from requiring sellers to collect sales tax on interstate shipments unless the seller had a physical

presence or “nexus” in the state where delivery occurred. *Quill* stemmed from a case concerning mail-order catalogs. However, since 1992, the number of sellers making remote sales to customers online has grown exponentially.

CSHB 2403 is narrowly drafted and only would deem retailers as being physically present in Texas if they had more than 50-percent control of a business entity in the state where the retailer sold substantially the same product line as the subsidiary, and did so under substantially the same business name. The bill also would cover out-of-state retailers more than 50-percent controlled by a Texas business.

The bill would further count subsidiaries whose facilities or employees in Texas were used to advertise, promote, or facilitate sales by the retailer or were used to maintain a marketplace in Texas for the retailer, including to exchange merchandise. Subsidiaries with a distribution center, warehouse, or similar location in Texas that delivered property sold by the retailer would also be counted.

Deeming these parent companies as physically present within Texas would be appropriate since the subsidiaries are engaged in either substantially the same business or they exist to facilitate the business of the out-of-state company.

CSHB 2403 would help close the business-model loophole. If this issue is not addressed, then new and existing businesses will alter their business structures to avoid having to collect sales tax, even though they may have a physical presence in Texas.

CSHB 2403 would help level the playing field between online and brick-and-mortar retailers. Many online retailers do not collect sales tax. This grants them an automatic price advantage over physical stores in Texas, which must collect sales taxes. CSHB 2403 would require an Internet retailer with a physical location in Texas through a subsidiary to collect sales taxes just as more traditional brick-and-mortar stores do. The bill also would discourage traditional brick-and-mortar businesses from spinning off their Internet sales divisions into out-of-state companies that then sell to Texas residents without charging sales taxes.

According to the fiscal note, CSHB 2403 would raise an additional \$16 million in general revenue in fiscal 2012-13. It would raise \$27 million in

general revenue in fiscal 2014-15. Given the current budget crisis, Texas cannot afford to lose this money.

CSHB 2403 would operate within *Quill* and would not usurp regulation better left to Congress. *Quill* allows states to require businesses to collect sales tax if the business has a physical presence in the state. The bill would not violate the decision because it would apply only to companies present in Texas through their subsidiaries, which perform related business functions. It would not affect businesses lacking a physical nexus to the state.

CSHB 2403 would not use the “affiliate” definition of nexus because this likely would violate *Quill*. Adopting affiliate nexus would mean considering a business to be engaged in business in Texas if it entered into an agreement with a resident Texan entity and the resident received a commission for referring potential customers to the retailer by any means, including a link on a website. There is not enough evidence that this commission-based relationship would constitute physical presence.

OPPONENTS
SAY:

CSHB 2403 would regulate Internet companies that are regulated more appropriately by Congress. Internet commerce provides a textbook case of the issues entangling interstate and international commerce. But the U.S. Constitution assigns the regulation of interstate and international commerce to the federal government. Piecemeal state statutes, like CSHB 2403, complicate an already byzantine system of sales taxes and regulations with which retailers must comply when doing business in multiple jurisdictions.

CSHB 2403 would inappropriately declare that an out-of-state business had nexus in Texas because it had corporate ties to other businesses in Texas. *Quill* ruled that businesses should not have to collect sales taxes under the differing tax rules and rates imposed by the states, cities, counties, and other taxing jurisdictions unless the businesses are physically present there. Requiring otherwise would be onerous to business and would stifle interstate commerce. Even under CSHB 2403’s definition of control, the out-of-state business would not be physically present in the state. Absent congressional regulation, out-of-state businesses lacking physical presence should not be required to collect sales taxes.

OTHER
OPPONENTS
SAY:

CSHB 2403 would not adequately tax out-of-state Internet sales. It would use a too-narrow definition of nexus. The bill should use click-through nexus in order to capture millions more of the sales taxes that are lost to Internet sales. This would enable the state to collect taxes that already are due to it, and would better level the playing field between online and brick-and-mortar retailers.

NOTES:

The committee substitute differs from the original bill by deleting a provision that would have established the use of a website on a server in Texas from which digital goods were sold or delivered as an activity establishing a retailer as engaging in business in Texas.