

Sales-tax collection likely in Amazon's future

8 April 2012, By Jim Brunner

When word emerged that Amazon.com Inc. was hunting for new warehouse sites, leaders in this business-friendly Southern state rolled out a welcome mat of tax breaks to lure the Internet retailer.

Code-naming their effort "Project ASAP," South Carolina officials offered up more than \$33 million in incentives, including free land, a property-tax cut and payroll-tax credits. They even agreed to loosen the area's Bible Belt moral code, repealing a decades-old Lexington County "blue law" so Amazon's warehouse could stay open Sunday mornings.

As they discovered, that wasn't enough.

Amazon also insisted on an exemption from collecting the state's 6 percent sales tax on purchases by South Carolinians. When the state Legislature balked, voting down the sales-tax break last spring, Amazon stopped construction on its million-square-foot warehouse and prepared to leave, throwing thousands of jobs into jeopardy.

The threat worked. After an intense fight that pitted Amazon and local economic-development boosters against small businesses and big retailers like Wal-Mart, lawmakers reversed themselves and handed Amazon a five-year sales-tax reprieve.

The South Carolina episode is one of many confrontations Amazon has faced in its national fight to hang on, for as long as possible, to one of its major advantages over brick-and-mortar retailers.

The world's largest Internet retailer currently collects sales taxes from customers in just five states, including Washington, giving it a price advantage of up to 10 percent in most of the country.

But the days of tax-free Internet shopping appear

to be coming to an end, something that Amazon itself has conceded in recent months.

States have lost more than \$52 billion during the past six years because of untaxed Internet purchases, according to a University of Tennessee study. Facing massive budget deficits that threaten further cuts to schools and social services, an ever-growing chorus of lawmakers has called for an end to the sales-tax edge long enjoyed by Internet retailers.

The backlash against the tax break - and Amazon's political tactics - has cut across party lines in many states, uniting tea-party Republicans and liberal Democrats alike.

"The perception of the company has changed 180 degrees. It is viewed as the bully in these situations," said Michael Mazerov, senior fellow with the Center on Budget and Policy Priorities, a critic of Amazon's sales-tax stance.

In Congress, bipartisan legislation to fix the online tax loophole is gaining momentum - and Amazon itself has strongly endorsed the proposals, so long as they also apply to its competitors.

"We have always supported a federal solution," said Paul Misener, Amazon's vice president for global public policy.

Not content to wait, at least 23 states already have enacted or proposed legislation to force Internet sales-tax collections.

For years, Amazon has responded to those state moves with bluster, lawsuits, threats to close warehouses and abrupt cuts of ties to thousands of websites in states that forced the tax issue.

"We have vehemently opposed the unconstitutional solutions that the states have taken," said Misener.

But recently, Amazon has backed down in the face of resolute governors and state legislatures, agreeing to collect sales taxes in several states despite its longstanding protestations that states had no legal right to force the issue.

Taxes were on Jeff Bezos' mind right from the beginning of Amazon.

He once told an interviewer he'd thought about founding his Internet bookseller startup on a California Indian reservation to escape taxes. When that proved impractical, Bezos settled on Seattle, in part because Washington's relatively small population effectively would leave more Amazon sales untaxed.

For more than a decade, Amazon has aggressively resisted individual state efforts to require sales-tax collections, citing a 1992 Supreme Court ruling that said businesses with no physical presence, or "nexus," such as a retail store, in a state cannot be required to collect sales tax.

That ruling, in *Quill Corp. v. North Dakota*, came in the case of a mail-order catalog. But it has been applied to online retailers, creating an ever-expanding loophole in sales-tax collections as more purchases are made over the Internet.

Technically, customers who buy goods online are required to pay their state's sales tax, but it almost always goes unpaid if Amazon or other online retailers do not add it to their bills. In Washington state, where Amazon does collect sales tax, the state estimates it will lose \$446 million next year from untaxed sales through other out-of-state Internet retailers.

In a May interview with *Consumer Reports*, Bezos said Amazon plays by the same rules as other companies, and it is up to Congress to fix the problem. "I don't think our customers would say, 'Why don't you guys just optionally collect the tax? I know you aren't required to do it, but aah, go ahead!'" he said.

Even as it has expanded nationally, the company has operated its warehouses and Kindle research lab in legal subsidiaries - arguing those facilities do

not count for sales-tax purposes.

"They are corporately separate, and (Amazon's) retail business is not the parent," Misener said.

According to confidential internal documents, Amazon also has tightly restricted employee travel to avoid taxes, instructing workers to beware of working in states where their presence might trigger tax liability.

The company has handed out a color-coded U.S. map to employees, ranking states from "green" for the safest destinations, to "red" for those that pose a "significant risk" requiring special approval to visit.

The company's map and travel policy were first disclosed by *The Wall Street Journal* in August. The *Seattle Times* obtained copies of the maps and related documents from court filings in a lawsuit brought against the company by a former Amazon software engineer.

In one internal memo, Amazon talked up the need for vigilance, noting the economic downturn has caused states "to become more aggressive and more focused" on Amazon's tax treatment, a trend "which could expose our business to significant tax costs."

Amazon's efforts to avoid collecting sales taxes are defensible in states where it truly has no physical presence, said David Brunori, professor of public policy at Georgetown University and contributing editor to *State Tax Notes* magazine. "There is nothing irrational or evil about that," he said.

But Amazon crosses the line by demanding such exemptions even where it has opened warehouses or other facilities, Brunori said, criticizing states that have cut deals allowing the company to avoid or delay sales-tax collections.

"You let them off the hook for what you make every brick-and-mortar retailer in the state collect? That runs counter to every notion of good tax policy," he said.

In South Carolina, leaders who gave Amazon the

sales-tax break say they have no regrets. After all, if they'd said no, the company would have moved its warehouse to a nearby state.

"It's easy to be against something if you have a job," said House Majority Leader Kenny Bingham, a Republican who represents the area near the Amazon warehouse. "We're going to get 2,000 jobs and \$125 million in investment we wouldn't get otherwise."

Going all-out to land a new Amazon distribution center was a "no-brainer," said Randy Halfacre, mayor of the town of Lexington and president of the local chamber of commerce. "It's not a sweetheart deal - we need these jobs."

With the nation's fourth-highest unemployment rate last year - and Wal-Mart as its largest private employer - South Carolina has worked hard to recruit new companies. The state boasts of its low unionization rates and regularly offers substantial tax breaks to corporations that relocate or open new factories here.

Amazon wasn't the first Seattle-connected company to take up South Carolina on those offers.

In 2009, Boeing announced it would build its new 787 production line in North Charleston, attracted by the nonunion workforce and an incentive package worth \$353 million over 15 years. And Starbucks built a coffee-roasting plant in Calhoun County, which got a \$2.25 million state grant to help make way for the facility.

The Amazon warehouse proved far more controversial. It wasn't the \$5 million in free land or the property-tax or corporate income-tax breaks - all viewed as the usual economic development enticements.

What angered opponents was the initially unpublicized pledge to Amazon by outgoing Gov. Mark Sanford's administration that the company would remain exempt from collecting South Carolina's sales tax.

That provoked a backlash from local retailers who said that amounted to favoring a giant out-of-state

"It creates an unlevel playing field for small businesses here in South Carolina that have paid taxes forever," said Buddy Delaney, who owns Best Mattress, a West Columbia store that's been in his family since 1928.

Even some local tea-party groups, despite their general anti-tax sentiment, opposed the deal as an insult to local businesses. "We just felt like it was really a matter of ... South Carolina's dignity," said Don Weaver, president of the South Carolina Association of Taxpayers.

This wasn't just a David vs. Goliath tale, though.

More like Goliath vs. Goliath.

As in the rest of the country, the fight in South Carolina became a proxy war between Amazon and some of its largest competitors.

The Alliance for Main Street Fairness, a national advocacy group funded in part by Wal-Mart and Best Buy, stepped into the fray with radio ads and a major political push to kill the deal. They succeeded at first, as the Legislature voted down the sales-tax break.

But opposition wilted after Amazon threatened to pull out of the state - and then sweetened its initial pledge of 1,250 jobs, boosting it to 2,000.

Three weeks after rejecting the deal, the South Carolina Legislature reversed itself, agreeing to give Amazon a five-year sales-tax reprieve, which would go away if Congress passes a national Internet sales-tax law.

As a minor concession, Amazon agreed to place a small notice on the bottom of its South Carolina orders, notifying customers they may be required to calculate and pay the state tax themselves.

Other states have grown reluctant to give in to Amazon, pursuing new legal arguments to redefine what it means for a business to have a physical presence in a state.

In 2008, New York passed a law saying Amazon had to collect sales taxes there because of relationships with thousands of local "affiliate" websites. Those sites are typically run by small businesses, blogs or nonprofits, which earn commissions by linking to products sold on Amazon.com.

Amazon sued to overturn the law but lost, and is collecting the tax.

In the past four years, many states have sought to follow New York's example.

In February, Arizona hit the company with a \$53 million tax bill for unpaid sales taxes over the past five years. The company said it would vigorously oppose the assessment.

A year earlier, Texas' comptroller slapped Amazon with a bill for \$269 million in back sales taxes, prompting the company to announce the closure of its Irving, Texas, warehouse, citing the state's "unfavorable regulatory environment."

But increasingly, Amazon has been conceding its days as a tax-free haven are numbered.

The most telling shift came in California, after the state Legislature approved several measures requiring Internet sales-tax collections by Amazon and similar Internet retailers. Those laws targeted Amazon's Web affiliates in the state, but also said the company's Kindle development facility in Cupertino was enough to establish tax liability.

Democratic Assemblymember Nancy Skinner, who sponsored one of the tax bills, said it made no sense to continue giving Amazon an edge over small businesses that give back to their local communities.

"I've never seen an Amazon-sponsored Little League team," Skinner said, echoing a complaint about the company's lack of civic engagement that has been sounded in its hometown of Seattle. At first, Amazon reacted to California's move with typical aggressiveness, immediately severing ties with its 10,000 California Web affiliates. The company then pledged \$5 million and paid

signature gatherers for a referendum campaign to repeal the laws.

But last summer Amazon abruptly dropped the referendum and announced a deal with California. The company said it would not fight the law in exchange for a one-year delay in collecting the sales tax. Amazon will start collecting California's taxes in September.

Since then, similar deals have been reached in other states where Amazon has warehouses. Amazon will be required to collect Pennsylvania's sales tax starting in September, under an administrative ruling. Indiana and Tennessee will follow in 2014. Internet sales-tax legislation has passed in Virginia and is actively being debated in several other states, including New Jersey, Georgia, Michigan and Florida.

In a statement this week, Amazon said it is "not opposed to sales-tax collection" and pointed out the company collects taxes in "half of the geographies where we do business." That includes Europe, where Amazon collects value-added taxes.

In recent months, Amazon has been vocal in its support of bills before Congress that would end the online sales-tax loophole on a national level.

Amazon's pivot has been met with skepticism by some of its Internet rivals.

Executives for eBay and Overstock.com fairly seethed with frustration during a Nov. 30 hearing before the House Judiciary Committee, blaming Amazon's belligerent tactics over the years for poisoning the atmosphere toward online retailing.

"A few large retailers, Amazon for example, have not operated in the spirit of the law and linked sales-tax collection to physical presence," said Todd Cohen, eBay's vice president for public policy, who argued sales-tax collection would prove burdensome to small retailers that sell through eBay.

But Misener told the panel there is no good reason for Congress to exempt eBay or others, which can easily calculate taxes with today's

sophisticated software. Amazon is even offering to do those calculations for smaller companies - for a fee. Distributed by MCT Information Services

"Widespread collection would no longer be an unreasonable burden on interstate commerce," Misener said.

After years of getting beat up as a tax bully, Amazon's new public stance may be a public-relations boon.

At the hearing, U.S. Rep. John Conyers, D-Mich., praised Misener's testimony: "Let the record show that there are corporate good guys in this world."

But some experts view Amazon's support for federal legislation as convenient, given a hyperpartisan atmosphere in Congress that may prevent any agreement on taxing Internet sales.

"Given the current anti-tax atmosphere, there is no way Congress is going to take away from voters what voters mistakenly view as their God-given right to shop sales-tax-free," said Richard Pomp, a state taxation expert at University of Connecticut School of law.

Even if Congress does act, some business analysts say no one should expect Amazon's retail growth to be derailed.

A report by William Blair & Co. found Amazon's prices would remain competitive even when sales taxes are added. After examining 2,400 products, the analysis found Amazon would still beat competitors' prices on identical items 46 percent of the time, even with sales tax.

Customers are drawn to Amazon's convenience, customer reviews and easy product comparisons - not just the sales-tax advantage, said Mark Miller, the analyst who wrote the report.

"For those who hold out hope that Amazon's momentum will be derailed by collection of sales taxes on a national basis - they might be sorely mistaken," Miller said.

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