Constitutional Limitations

Technology and taxation have never been simple. Recent Congressional and state attempts to tax remote sales are a flashback to the early days of taxing software. In today’s world, one state’s in-state seller is another state’s remote seller and the products and services sold may not have a physical world equivalent. In this article, Katherine Gauntt takes you on a trip down memory lane by examining the parallel paths of technology and taxation and illustrating how our failure to design tax law specific to the virtual business models continues to haunt us.

Dèjà Vu on Main Street: How History Repeats Itself in a Virtual World

By Katherine Gauntt

Introduction

Sales tax has come a long way since the days when it “got no respect” and was considered the Rodney Dangerfield of the tax world. Most companies now realize it’s not just a simple pass through tax but one that requires an understanding of business operations, sales methodology and both the physical and virtual footprint of the corporation. Most states have realized sales tax offers the option of increasing tax revenues while adhering to a “no new taxes” pledge simply by expanding the tax base or broadening the definitions promulgated by existing law. For years, practitioners relied upon the general rule that tangible personal property is taxable unless an exemption exists, and services are non-taxable unless promulgated as taxable. However, if services can somehow be defined through a broad interpretation of tangible personal property, existing law offers sufficient cover to maintain the “no new taxes” pledge. In addition, if the “form” of the transaction can be narrowly construed despite what logic dictates, the states can assert taxation on an even broader base of transactions.

Before tax can be applied, nexus must be established and, despite all efforts to the contrary, Quill1 is still the law of the land. Nevertheless, the physical presence

standards established in *Quill* are eroding through recent developments in economic nexus and affiliate nexus. The states continue to need a silver bullet\(^2\) to eliminate the *Quill* physical presence standard permanently. The “Marketplace Fairness Act of 2013”\(^3\) (the “MFA”), appears to be this silver bullet. The general belief by some is that requiring remote sellers to collect sales tax will result in a windfall of uncollected sales tax for the states.\(^4\) Under the current version, a small seller exception exists where remote sellers with $1,000,000 or less in U.S. revenue for the preceding calendar year do not have to collect the tax.

The cornerstone of the MFA triggering remote seller taxation is the simplification to current tax law brought about by the “Streamlined Sales and Use Tax Agreement”\(^5\) (the “SSUTA”). [emphasis added] However, simplicity for the taxation of today’s virtual services provided by remote sellers is largely absent. What is missing in SSUTA simplification is the acknowledgement that remote sellers engage in significantly more commercial activity than the mere act of taking orders for tangible personal property over the Internet. The fundamental flaw is that the simplification is constructed upon the premise that products, services, sellers and buyers act the same in physical commerce as they do in virtual commerce. It is assumed that products, services, sellers and buyers can be easily identified, segregated, priced and sourced in an interconnected technological environment. Since that is not the case for a significant number of virtual products and services, the application of tax becomes an exercise in risk tolerance where no explicit rules exist for businesses wanting to comply, but at the same time, wanting to do right by their customers. Should the MFA be passed and remote sellers be required to collect sales tax under the current rules and definitions, businesses large and small that are leveraging virtual services will be at risk for contingent liabilities since the rules are neither simple nor clear.

Nevertheless, as business shifts from a manufacturing economy to a service economy, the states will continue to need tax revenue to provide goods and services to fulfill the social contract with their citizens. However, the states should engage in simplification efforts targeted toward remote businesses rather than attempting to adapt the laws of a physical business model to that of a virtual one. Pragmatic simplification efforts which are based merely upon access to a state’s economic market space is a violation of the protections afforded by the commerce\(^8\) and due process clauses.\(^9\) With every change in business practice and/or tax policy, companies selling and buying virtual services risk contingent liabilities brought about by the inconsistent application of 20th century tax law to 21st century business practices. Perhaps a trip down memory lane will serve to enlighten us as to the confusion, lost opportunities and complexities of taxation in this virtual world.

**Discussion**

If anything, the 15 years it has taken to “simplify” the rules and the dominance of rulemaking states that have no skin in the game\(^10\) should be the first clue that consumers of technology and services will be subjected to an inconsistent application of sales tax on these services. The complexity is partially driven by the fact that state tax law is generally one or two technological shifts behind the business world. In the 1980s, the big sales tax issue was the taxation of freight. Meanwhile, software was becoming commonplace. The 1990s brought personal computing but the states were focused on mail order. The pace accelerated in the 2000s when the states focused primarily on software (the canned variety) while businesses were leveraging the Internet for procurement, sales and electronic payments. Currently, states are beginning to issue guidance (albeit conflicting) which focuses on “cloud computing” (“cloud”) while “the Internet of things” (“IOT”) is becoming mainstream. Business models have undergone a major shift from physical to virtual with entrants into the transportation (Uber), lodging (Airbnb), labor (Task-Rabbit) and logistics (Deliv) marketplaces no longer conforming to the older capital-intensive business models but instead seeing themselves as service business models connecting a sharing economy.

In the virtual world, one state’s in-state seller is many a state’s remote seller. We’ve progressed to the point that there is no longer a clear delineation between a brick and mortar store and a remote seller. In today’s world, business uses many sales channels. In the virtual world, markets can no longer be confined to a single point of entry or exit.

**Historical Perspective—Technology to Year 2000.** In 1965, Gordon Moore, co-founder of Intel Corporation, predicted that “The number of transistors incorporated in a chip will approximately double every 24 months.” In his 1998 presentation for the IEEE\(^11\), Gordon Moore predicted “Integrated circuits will lead to such wonders as home computers...automatic controls for automobiles, and personal portable communications equipment. The electronic wristwatch needs only a display to be feasible today.”\(^12\) What Moore knew that most people did not was that the semiconductor industry was

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\(^2\) Silver bullet is a colloquialism used to infer the act of killing the un-killable (as in werewolves.)

\(^3\) The Marketplace Fairness Act of 2013. 113th Congress, S.743.

\(^4\) Others in the technology and services sector believe the products and services currently leveraging the Internet have no physical equivalent so no tax revenue is lost per se. This Internet revenue is the result of new products and services invented by Internet entrepreneurs.

\(^5\) The Marketplace Fairness Act of 2013; §2(c).

\(^6\) Streamlined Sales and Use Tax Agreement, adopted Nov. 12, 2002.

\(^7\) U.S. Constitution, Amend. X also known as state’s rights clause

\(^8\) U.S. Constitution, Art. I, §8, Cl. 3 also known as commerce clause

\(^9\) U.S. Constitution, Amend. V and XIV also known as due process clause

\(^10\) SST states account for less that 25 percent of technology GDP and have the least amount of technology workers. This infers that there is less political cost to the SST states to enact law unfavorable to remote sellers.

\(^11\) Institute of Electrical and Electronics Engineers.

developing exponentially faster, more integrated and more reliable electronics. Material changes in computing, networking, storage, and communication devices that handle the ever-growing digital content and information demands of the market would continue to occur. This new integrated platform would eventually create a hardware-to-software shift, enabling applications previously constrained by size and speed to flourish.

In this same time frame, visionaries such as Jeff Bezos (Amazon.com, 1995), Pierre Omidyar (eBay.com, 1995), Larry Page and Sergey Brin (Google.com, 1996), Shawn Fanning (Napster.com, 1999) and Steve Jobs (Apple.com, 1996) leveraged integrated circuit technology as a platform for new applications and services. This was a key change in business-related Internet usage from primarily that of communications and calculations tool to a tool focused on inventing markets promoting the user experience. The Internet became the pipeline, not the purpose for the application. Visionary companies such as Microsoft (Windows 95, 1995), Pizza Hut (Online Ordering, 1994), Office Depot (B2B Site, 1996), and Apple (Powerbook 100 Series - 1991) created new markets and introduced applications which were accessible to everyone—not just businesses with IT departments full of IT technicians.

The year 2000 (Y2K), brought the limitations and possibilities afforded by both traditional and Internet technology to the masses. The media promoted stories predicting cataclysmic failure of computers and networks in manufacturing, telecommunications and infrastructure upon the flimsy of the millennium and in doing so, inadvertently educated the general public on basic technology systems and processes. Businesses simultaneously upgraded their hardware and software to avoid those potential failures. Y2K provided a collective understanding through crisis of our somewhat invisible dependence upon technology in our everyday lives and, more importantly, empowered businesses to collectively make a simultaneous leap into the latest technologies by replacing older technologies all at the same time.

**Historical Perspective—Taxation to Year 2000.** Meanwhile, the tax world was grappling with whether software delivered on a floppy disk was tangible or intangible property. A physical presence nexus standard became law under Quill in 1992 while the world progressed toward digital applications and services. States that were investigating Internet sales viewed Internet platforms, Internet access and Internet applications as a glorified order entry system for tangible goods and lumped them all together as eCommerce. The brick and mortar business model was beginning to erode as businesses began to understand the efficiencies and new markets brought about by the surge in Internet awareness among consumers. Individuals and small businesses not only began directly selling over the Internet, but third party brokers created markets to bring buyers and sellers together. Data and content began to be monetized. The states began to sense that the barrier to sales tax nexus created by Quill stood between them and a mother lode of uncollected tax as a result of eCommerce. Businesses with nexus in states where they also engaged in eCommerce were faced with confusing, contradictory and worse, silent tax code. The existing laws for the taxation of tangible personal property were all that was available and the states interpreted (some would say shoehorned) those laws to fit eCommerce. A single visit to a state by company employees became the threshold for sales tax nexus in some states, thus allowing those states to assert an obligation to collect sales tax upon that business despite Quill. Most states still held the narrow view that the Internet platform merely enabled the sales of tangible personal property rather than the view that the platform, in and of itself, would become the object of taxation. Certain “early Internet taxation adopters” such as Tennessee and Wisconsin issued letter rulings in 1997 which defined Internet access and associated services as telecommunications services. Those services were already subject to tax in those states. Connecticut chose to tax Internet access under existing computer and data processing statutes until July 2001.

On the federal level, Congress was busy overhauling the nation’s telecommunications law which culminated in the passage of the Telecommunications Act of 1996 (the “Act”). The stated purpose of the law was to open telecom markets to competition by deregulating the telecom monopoly and create a national policy framework. Deliberations under the auspices of the Telecommunications Act of 1996, 42 U.S.C. § 251 et seq. (1982).
Act raised the awareness of emerging issues surrounding the taxation of the Internet which culminated in the passage of the Internet Tax Freedom Act in 1998 ("ITFA"). ITFA placed a temporary moratorium on the taxation of Internet access by the states and prohibited multiple and discriminatory taxation of electronic commerce. However, Congress also provided that any state currently taxing Internet access could continue to do so and that no provision was intended to supersede state’s rights. The Advisory Commission on Electronic Commerce (ACEC) delivered its report to Congress in April 2000 which proposed the following: (1) Clarify nexus standards for remote sellers; (2) Draft uniform sales and use tax law to simplify taxation and promote parity between remote sellers and single jurisdiction sellers; (3) Establish a new advisory commission responsible for oversight of progress to create uniform tax law; and (4) Make ITFA permanent.

Concurrent with ACEC, the National Tax Association, Communications and Electronic Commerce Tax Project (the “NTA Project”), a consortium of business, state and local government, professional organizations and academia also deliberated a possible solution that “…identifies and explores the issues involved in applying state and local taxes and fees to electronic commerce and that makes recommendations to state and local officials regarding the application of such taxes.” The NTA Project became the precursor to the Streamlined Sales Tax Project despite having failed to reach agreement on sales tax and telecommunications tax reform. The NTA Report contained a Prefatory Caveat (“Nothing is agreed to unless everything is agreed to”) as a result of its failure to reach consensus among the members. The final report rightly identified the sources of complexity as tax rates, tax base and tax administration, and includes electronic publishing, but does not include any use of any such capability for the management, control, or operation of a telecommunications system or the management of a telecommunications service.” A carrier providing information services is not a ‘telecommunications carrier’ under the Act.

Historical Perspective—Streamlined Sales Tax Year 1999 to 2005. The convergence of rapidly evolving technology and varying degrees of consensus by numerous committees set the stage for the creation of the Streamlined Sales Tax Project ("SSTP"). In 1999, the National Tax Association ("NTA") and the National Conference of State Legislatures ("NCSL") requested tax administrators to develop a sales tax system that was (1) less complex; (2) addressed the lack of a level playing field for in-state vs. remote merchants; and (3) addressed the loss of revenue from states unable to collect tax imposed. The initial Streamlined Sales and Use Tax Agreement (“SSUTA”) was drafted in November of 2002. The major stated purpose of the SSUTA included (1) state level administration; (2) uniform state and local tax bases; (3) uniform tax base definitions; (4) simplified rates; (5) uniform sourcing; (6) simplified administration; and (7) privacy protections. Input into the final draft of the SSUTA was sought from governmental, academic and business alike and, for a time, there seemed to be genuine cooperation, common purpose and compromise between interested parties.

The SSUTA became effective Oct. 1, 2005, when the SSTP states determined at the SSTP Petitioning States meeting in Chicago that they represented at least 20 percent of the country’s population and that they were in substantial compliance with the Agreement’s provisions. The 20 percent threshold was at risk of being unachievable until the destination-based sourcing provision was changed to allow for intrastate origin-based sourcing. Once destination-based sourcing was conceded, Ohio agreed to join SSTP and brought with it the population to meet that threshold. However, the business community had been explicit from the beginning that origin-based sourcing was one of the complexities associated with compliance and, to some, this was a turning point for what started as a “level playing field” between business and the states had not tilted in favor of the states. Previously, North Carolina had run into trouble passing legislation repealing the reduced rate on the machinery exemptions. Despite the provisions of the SSUTA prohibiting replacement taxes, North Carolina repealed its existing 1 percent sales tax on machinery to be in compliance with SST but immediately replaced it with an identical 1 percent privilege tax which
is not governed by the terms of SSUTA. Many in the business community saw this as a bait and switch move and this action became an indication that the collaborative spirit of the SSUTA had begun its decline. That, coupled with the exceedingly slow pace of deliberation and execution, contributed to the decline in participation by many business representatives, especially those in technology and remote sales. In general, participation by traditional brick and mortar businesses remained steady as their interests were served by the taxation of remote sellers.

The Present—Technology Continues Exponential Growth. In 1995, approximately 20-30 million out of 5.7 billion people (0.04 - 0.5 percent) of the world’s population used the Internet. By the end of 2014, the International Telegraph Union (“ITU”) predicts that 43 percent of the world’s population will be Internet users. In developed countries, 78 percent of the population has Internet access. Additionally, mobile broadband subscriptions are held by 32 percent of the world’s population. As more applications and services have exploded, the catchall days of “eCommerce.” The Internet is a tool used in different ways by people of different genders, races, ethnicities and age for user-enabled communication, research, education, financial transactions, entertainment, social interaction, real time news and, yes, shopping. Many applications that existed today were not invented 15 years ago and, more importantly, have no equivalent in the physical world.

Today, both business and consumer alike are heavily into cloud-based services which, interestingly enough, had already begun to be commercialized in 1998 and 1999 with the founding of VMware and Salesforce.com respectively. Significant innovations in virtualization and distributed computing, as well as improved access to high-speed Internet and a weak economy, accelerated interest in cloud computing due to its convenience, cost and scalability. The U.S. Government invested in cloud technologies throughout the first part of the 2000s. The invention which marked the shift into the cloud by mainstream business in 2005 was the launch of the Intel Pentium 4 processor, the first processor to support virtualization. Virtualization was the logical first step toward cloud-enabled virtual services. Amazon, Dropbox, Appitis Inc., SecureVault Corp. and SAP leveraged virtualization and commercialized various cloud-based applications from 2006 to 2010. This commercialization of cloud-based technologies opened the door for many of the applications that were formerly constrained by size and speed. More importantly, the emergence of handheld “smart” telecommunication devices as a means for receiving and sending digital information meant that any user with a smart phone and access to the application (or “App”) could engage in real-time activities over the Internet anytime, anywhere without the limitation of storing data or software on a device before being able to access it.

Fast forward to 2014 when the so-called “Internet of things” (“IOT”) has entered the mainstream. The IOT is the convergence of the services and manufacturing business sectors whereby everyday devices provide enhanced functionality due to embedded network connectivity. These devices are able to collect, send and receive data to and from each other and allow a single data element to affect the functionality of several interconnected devices. For example, a building with an interconnected thermostat and lights (so called “smart devices”) may exchange temperature data to signal each other to automatically lower the temperature gauge on the thermostat when the lights are turned on since the lights generate a certain amount of heat when turned on that increases over time. This exchange of data between devices supports a more efficient use of energy to heat the building, but that is its only function. A human could manually figure out the same thing, but smart devices perform the task without human intervention other than setup. Self-driving cars and devices controlled by a phone are both now a reality. The IOT will test the concept of “bundling,” since the device is tangible personal property, but the object of buying such a device rather than a traditional human-administered one is its ability to manage remotely without human input over networks and the cloud.

The Present—Taxation Continues. While the rest of the world is embracing IOT technology and using the Internet as a catalyst for invention, the big debates of 2014 in the sales tax world revolved around the taxation of the cloud and the Marketplace Fairness Act of 2013 (“MFA”). The MFA proposes allowing states that adopt simplification and uniformity measures such as those promulgated in SSUTA to require certain vendors having no physical presence (e.g. remote sellers) to collect and remit sales tax. The MFA passed the Senate with bipartisan support in May 2013 but stalled in the House of Representatives with Speaker John Boehner refusing to allow a vote, effectively killing the bill for the 113th Congress. The reasons vary but generally fall into the following areas: (1) the MFA creates a new tax; (2) remote sellers have a competitive advantage over brick and mortar sellers since they do not collect the tax; (3) enactment would dramatically increase the administrative burden on remote sellers.

The first reason is clearly not the case since the states have a compensatory use tax if the vendor does not charge sales tax. There is no “new” tax here. The compensatory use tax just cannot be enforced by the states due to the dispersion of consumers and cost/
benefit of enforcement for low dollar taxes due. Reasons two and three have varying degrees of truth and merit. Now that most brick and mortar sellers have an Internet sales channel and mom and pop sellers can do business outside traditional physical boundaries over the Internet, the level playing field argument is outweighed by the low cost of not entry. One state’s in-state seller is another state’s remote seller. The administrative burden remains complex for all sellers but especially remote sellers and small businesses. Despite the simplification efforts by SSUTA, we are still applying yesterday’s tax law to today’s business models. The level of expertise required to make thoughtful tax decisions without assuming risk from either the state (through audits) or the customer (through qui tam lawsuits) is not available to the average taxpayer making remote sales. It is certainly not available for startup companies inventing new markets.

What the MFA fails to address is best illustrated by the state’s second focus in 2014, which is the taxation of cloud computing. First, what are we really subjecting to tax? The current subscription-based pricing “bundles” taxable and non-taxable components together to simplify the sales model since delivery of the service requires the integration of telecommunications, hardware, networks and applications. Second, where does it come from? By definition, it’s not of this earth but is rather “in the cloud.” Even those that operate cloud services cannot tell you where your data is at any given moment. Third, what activities have established nexus? The applications and data reside everywhere and nowhere. It would be like trying to separate the waters of the Mississippi River in New Orleans based on where each drop originated.

Recently, both Georgia and Tennessee examined the taxability of a cloud-based collaboration service offered by a taxpayer with no physical presence in either state. The taxpayer provided cloud-based services to support the customer’s telecommunications equipment through remote applications for processing and routing calls, remote performance monitoring and general administration of setups. Georgia ruled that the taxpayer services were nontaxable services that did not constitute taxable sales of hardware or software. Using the same set of facts, Tennessee deemed the cloud-based collaboration services taxable telecommunications services. In its ruling, Tennessee concluded that the taxpayers services did not constitute the sale of tangible personal property or computer software but did constitute the sale of telecommunications services since the taxpayer used “computer processing applications to provide customers with voice, video, presence and mobility capability in conjunction with its customers’ Public Switched Telephone Network connections.” (e.g. routing voice, data, audio etc.) Moreover, Tennessee found the telecommunications services to be intrastate and thus subject to a higher local tax rate. In deeming the telecommunications services intrastate, the letter opined that “Although the taxpayer’s data center, software and hardware are located in the state of [STATE], the taxpayer’s service of using computer processing application information to act on a customer’s content occurs where its customer is located.” In addition, the tax base consisted of the entire monthly fee.

There is also the general misconception that by not taxing remote sellers, we are impacting small business. If anything, failing to simplify the sales tax code has a far greater effect on small business which has embraced the Internet for its market expansion capabilities. In 2007 (the latest year of complete census data for this purpose), 79 percent (4.8bb) of all U.S. businesses had less than 10 employees. Approximately 0.3 percent of all businesses in 2007 were classified as “Internet Service Providers, Web Search Portals, and Data Processing, Hosting and Related Services” and those businesses grew by 7.6 percent between 2007 and 2008.

The activities surrounding the MFA seem like a strange déjà vu back to the days of the ACEC, the NTA the SSTP and the passage of IFTA by Congress. Now as then, the issues of nexus and tax base cannot keep up with the technological advances of the 21st century. As for simplification, only the taxation of digital products such as e-books came close in providing a clear definition since there is a physical equivalent to the virtual product.

The cornerstone of the MFA to justify taxing remote sellers is the simplification brought about by SSUTA. This fails to take into account that the SST states may not be the best drivers of technology taxation since most of the SST states have no political skin in the game when it comes to taxing technology. The SST states have fewer technology workers (aka voters) and fewer technology companies (based on number of companies, not revenues) than non-SST states. When measuring total compensation by technology worker, the total compensation to technology workers in the 23 SST states accounts for less than 25 percent of total U.S. technology worker compensation. The same holds true for technology GDP where the SST states contribute less than 25 percent of the total U.S. GDP. Interestingly, when the GDP attributable to the heavy users of technology is examined in the SST states, there is an increase to 30 percent GDP for those companies.

The data in the appendix is compelling when you consider that the SST states make up 30 percent or less of the technology workers, the technology sellers, the technology users and the general population of U.S. consumers. Nevertheless, the SST states are driving sales tax policy on a Federal level as the standard for...
overturning Quill and opening the door to tax remote sellers of products and services.

**Conclusion**

"Those who cannot remember the past are condemned to repeat it." —George Santayana

While the past 20 years of technological possibilities has brought about major changes in business practices, technology-based businesses have experienced significant degrees of uncertainty due to the application of tax law intended for tangible personal property to the taxation of intangible goods and services. The compensatory use laws were enforceable 20 years ago in the drop-ship, mail-order world of taxable tangible personal property. However, the Internet flattened the supply chain, small businesses began to provide Internet services to consumers, the economic engine shifted to a service economy and the transaction audit trail became more ambiguous. Buyers and sellers alike became part of a dispersed Internet B-to-B, B-to-C and C-to-C57 population. The TPP based economy morphed into a virtual service one and the tax law did not keep pace. At least the protections afforded by Quill, allows remote sellers to have some measure of certainty if they do not establish physical presence. In states where physical presence is established, those businesses exist with a high degree of uncertainty which creates the potential for contingent liabilities under ASC450.58

The SSUTA has, in fact, simplified the sales tax code from how it existed 20 years ago. However, the benefits of simplification are, for the most part, limited to traditional manufacturing, distribution and retailing business models. The current SSUTA definition of “tangible personal property” is “personal property that can be seen, weighed, measured, felt, or touched, or that is in any other manner perceptible to the senses” [emphasis added] and includes “electricity, water, gas, steam, and prewritten computer software.” SSUTA defines “tangible personal property” in the administrative definitions59 rather than in the product definitions.60 The term “services” is notably undefined in the Administrative Definitions61 but is addressed under specific service definitions in Part II of the Product Definitions. Interestingly, definitions related to various “telecommunications services” can be found within the SSUTA62 in Appendix C Parts I63 and II64. Since “telecommunications services” are the closest we can come to today’s cloud and IoT service models in the sense that they are networked services leveraging distributed networks and storage to perform functions, the SSUTA in its current form does not provide a simple, well-defined tax treatment upon which, without an explicit product definition, a remote seller of these and other virtual services can standardize its compliance across multiple states.

Absent a definition and specific guidance for virtual services, certain services could be deemed “...perceptible to the senses” since the consumer is aware when services are provided and/or consummated. Since services such as cloud and IoT can be “perceived” and telecommunication and/or prewritten software is inherent in the function of cloud and IOT, the states could deem the service taxable.65 Since tangible personal property is not defined under the product definitions, the state is not required to consistently apply tax to anything meeting that definition in order to maintain compliance with the SSUTA provisions for member states.66 Practitioners understand that SSUTA likely used an administrative definition rather than a product definition so as not to run afoul of state courts which have applied different definitions of what constitutes “tangible personal property” through the years.67 Nevertheless, the significance of the placement lies in the fact that the states can broadly interpret the administrative definitions and can exempt certain types of tangible personal property (e.g. electricity) while taxing others (e.g. pre-written computer software). In addition, basic concepts such as “resale of services” lack definition and guidance under SSUTA. In some states, a service must remain intact to be “resold.” However, integration and interdependency are the basis for today’s virtual services. The “supply chain,” as it were, is more analogous to a “supply web” where the delineation of actual services to prove a resale exemption is difficult at best. There is a strong possibility for cascading of tax liability where virtual services by multiple vendors are resold to other virtual service providers resulting in multiple tiers of taxation for the remote seller.

The fundamental flaw in the MFA/SSUTA approach is the reliance upon the premise that products, services, sellers and buyers will continue to be easily identified, segregated, priced and sourced in this new interconnected technological world. This is a reasonable construct in the physical TPP world, but without simplified tax law which can be understood by the millions of small sellers on the Internet, the passage of the MFA under the premise that SSUTA has simplified sales tax will merely repeat the sins of the past 20 years. The downside risk for small businesses is significant (regardless of the $1mm exception) in terms of customer service, disclosure of revenues and costs of compliance.

56 George Santayana (1905) Reason in Common Sense, p. 284, volume 1
57 Business-to-Business, Business-to-Consumer, and Consumer-to-Consumer
58 Remote sellers experience a high degree of uncertainty selling new services where the tax law is unclear or absent. This uncertainty becomes significant upon acquisition and/or audit. The risk is magnified for publically traded companies since ASC 450 requires contingent liabilities to be disclosed in financial statements if the liability is probable and estimable. While the probability might not be evident, the estimated tax can likely be quantified and may require a footnote to the financials highlighting the risk.
59 SSUTA; Part I
60 To practitioners and experts in the field, this construction makes some sense because a sales tax has always been imposed on TPP. However, layman sellers may not understand the nuance.
61 As of the latest version of the SSUTA amended 10/8/2014
62 Communications channel—SSUTA Article III, Section 315.
63 Telecommunications nonrecurring charges—SSUTA, Appendix C, Part I, within “sales price” definition.
64 800 Service—SSUTA Appendix C, Part II.
65 The states could also claim the use of taxable tangible personal property in conjunction with a non-taxable service renders the entire transaction taxable despite any “true object” considerations.
66 SSUTA, Sec. 327 (C).
67 State v. Jones, 137 P. 2d 970 (Ariz. 1943); Ramco, Inc v. Director, Department of Revenue 248, N.W.2d 122 (Iowa 1976); See also SSUTA Tangible Personal Property Issue Paper, April 15, 2002.
Most small businesses and the CPA firms that service small business do not have the level of tax expertise necessary to maintain compliance. Only large companies have the resources to have in-house staff and/or engage the outside experts with the knowledge to interpret the nuance of current law with respect to virtual services regardless of SSUTA simplification effort.

Without a definitive, objective and timely interpretation of tax law which is intended for and specific to virtual service transactions, the SSUTA in its current form is not simple. The MFA allows for the elimination of the Quill physical presence standard based on the presumption that it is. So, while the defense offered by Quill against the states asserting nexus may not be the solution to the taxation of virtual services for the business community, it does create a barrier between the states and remote sellers until tax law catches up. If states want to fulfill the social contract and protect state sovereignty, they must create tax law specifically designed for the virtual world that recognizes and acknowledges the vast differences between the tax law for traditional sellers, traditional Internet/remote sellers and remote sellers of virtual services. The excuse that the law protects remote sellers at the expense of brick and mortar sellers no longer applies because they are now one and the same. Instead, Quill protects the new economy from some degree of financial uncertainty associated with tax compliance in a vacuum. The real unlevel playing field has now become the difference in the ability to comply with current law, simplified or not, between companies operating in the physical world and those operating in the virtual world and the level of risk each must assume to participate in the new economy.

### Appendix: COMPARISON OF TECHNOLOGY EMPLOYMENT AND GDP BY SST AND NON-SST STATES

<table>
<thead>
<tr>
<th></th>
<th>% Compensation Technology Workers</th>
<th>% GDP Technology Sellers by State**</th>
<th>% GDP Technology Users by State**</th>
<th>% of Population 2013***</th>
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<tbody>
<tr>
<td>NON-SST STATES (22 States + DC)</td>
<td>73.86%</td>
<td>74.48%</td>
<td>67.42%</td>
<td>75.9%</td>
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<tr>
<td>SST STATES (23 States)</td>
<td>24.56%</td>
<td>24.90%</td>
<td>30.19%</td>
<td>22.5%</td>
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<tr>
<td>NO SALES TAX STATES (5 States)</td>
<td>1.58%</td>
<td>1.62%</td>
<td>2.39%</td>
<td>1.7%</td>
</tr>
</tbody>
</table>

** Data Source: http://www.bea.gov/itable/iTable.cfm - GDPbyInd_VA_NAICS_1997-2013.