

Before the House Committee on the Judiciary

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Constitutional Limitations on States' Authority to Collect Sales Taxes in E-Commerce

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Chairman Smith and Members of the Committee,

My name is Dr. Patrick M. Byrne. I am the Chairman and CEO of Overstock.com, Inc., an E-commerce retailer which last year had 1,500 employees, \$1.1 billion in revenue and \$14 million in net income. Thank you for the invitation to testify today as the Committee explores the constitutional limitations on states' authority to impose sales tax collection obligations on non-resident E-commerce retailers like Overstock. I have views on this subject because, from my experience, I believe that if the proposed collection obligations had existed in October 1999 when Overstock.com launched, we would likely not be here today. The odds against a new online business being successful are long in any case, but requiring online businesses to collect sales tax on behalf of remote state governments without remuneration, simplification and indemnity, make those odds even slimmer. So I appreciate this opportunity to share my views on this subject.

About Overstock

Overstock is a publicly traded Utah-based Internet retailer that launched in 1999 with 18 employees and \$1.8 million in sales. In 2010, Overstock had 1,500 employees, all in Utah, \$1.1 billion of revenues, and \$14 million of net income. We offer a wide variety of high-quality, brand-name merchandise and services at discount prices, including bedding, home decor, appliances, watches, jewelry, electronics, sporting goods, clothing, shoes, cars, vacations and insurance. We give customers an opportunity to shop for bargains conveniently, while offering manufacturers, distributors and other retailers an alternative sales channel.

In 1999, we offered less than 100 products for sale; today the number is about 1 million. For each of the last six years, various industry groups, including the National Retail Federation and American Express, have routinely ranked Overstock as #1, 2, 3, or 4 in customer satisfaction among all U.S. retailers, online and off. In 2010, Forbes ranked Overstock as the number one retailer in employee satisfaction, and Glassdoor ranked Overstock ninth in its list of top 50 corporations in America to work.

We have long been noted for our corporate social responsibility. In 2001, we launched Worldstock Fair Trade, Overstock's socially responsible store for products handcrafted by artisans from developing nations and rural areas of the USA. The department distinguishes itself from its competitors by returning between 60-70% of the sales price to the artisans. To date, we have returned more than \$73 million to Worldstock's artisan suppliers. We donate all profits from Worldstock to charity, and we use most to build schools and orphanages in some of the poorest nations in the world. For us to be here today, my colleagues at Overstock have had to be fanatics about service, adaptation, and innovation.

The Burden of Remote State Sales Tax Collection

The question the Committee must consider is whether innovative remote sale companies will emerge, employ Americans, and help our economy grow if Congress alters the status quo by allowing states to burden interstate commerce. In my opinion, the pending bills allow states to shirk their responsibility to administer and collect the taxes they impose on the taxable "end consumer." Instead, they pass that burden on to non-resident, non-voting businesses. Passage of such legislation would curtail the emergence of the next innovative E-commerce company and poison the Internet's fertile ground for growth and innovation.

Overstock is physically present only in Utah. All of our operations, servers, and employees are located in Utah. As I have already indicated, if when we launched in 1999 and had only \$1.8 million of revenue, we had been required in states in which we had no presence to calculate and collect sales tax in thousands of separate taxing districts, respecting their thousands of unique taxing practices and tax holidays, we would not have survived to grow and provide the 1,500 jobs we now do. The cost of compliance in what is currently reported as 9,746 taxing jurisdictions, the unavailability—even today—of affordable off-the-shelf plug-and-play software solutions, the cost of employing and training people to implement and run the software, the administration and resolution of state audits and resulting assessments, and the risk of penalties and suits by plaintiff bar attorneys for software errors and omissions, would have been too high a hurdle to overcome. I imagine the same could be said for Newegg, Amazon, eBay and other E-commerce start-up companies that have blossomed over the last decade.

We oppose the pending bills because they "outsource" to retailers, without compensation, the burden of collecting taxes from residents of states where those retailers have no physical presence nexus. The absence of a physical presence nexus requirement, the long-standing Constitutional standard to be met before states may impose burdens of taxation beyond their borders, makes remote sales tax collection a burden on innovation, entry, and commerce. The taxing jurisdiction should be primarily, if not exclusively, responsible for collecting sales tax from its residents. If states want or need to hire retailers to collect sales taxes from their residents, true "fairness" requires that the states provide them with: (1) plug-and-play software

solutions, (2) indemnification from computation, collection, and administration errors, and (3) compensation for doing the tax collection work on behalf of those states.

Why Nexus is Critical

It is unfair to allow states the ability to impose collection obligations on remote E-commerce retailers that have no physical nexus with the state. Imposing such an obligation on a company that has no political say in the taxing decision, the election of state and local officials who make that decision, or how the tax revenues are used, is about as perfect a definition of taxation without representation as can be devised in the 21st Century.

For a remote seller, determining what transactions are taxable and at what rate in a given jurisdiction is extremely complex. For example, we sell gift baskets. Some of the nearly 10,000 taxing jurisdictions impose sales tax on the entire basket of goods, others exempt food products from taxation, and others treat some of the products as candy subject to a higher tax. I trust you see the problem. Back-to-school sales tax holidays for clothes and supplies are another example. It is far easier for retailers with a physical presence in a jurisdiction to know the tax nuances of their jurisdiction. But it is vastly more complex for an E-commerce retailer with thousands or millions of products to know the specifics of the nearly 10,000 taxing authorities where they are not physically present. Thus, if Congress allows states to shift the sales tax collection obligation to retailers, it must require that states supply the software solution. Failure to do so exacerbates the heavy burden to entry of startups and small businesses.

The Status Quo is a Success

In *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the U. S. Supreme Court articulated a bright-line physical presence requirement before North Dakota could impose a collection burden on an out-of-state mail order business (a business model nearly identical to online retailers). The Court stated:

Moreover, a bright-line rule in the area of sales and use taxes also encourages settled expectations and, in doing so, fosters investment by businesses and individuals. Indeed, it is not unlikely that the mail-order industry's dramatic growth over the last quarter-century is due in part to the bright-line exemption from state taxation created in *Bellas Hess*.

The physical presence standard of *Quill* has worked successfully, enabling technology companies like Overstock to innovate and thrive in the retail marketplace, bring unprecedented value, choice and convenience to consumers, and enable small retail stores throughout the country to supplement their sales through our web sites.

A Fairer Approach if a Federal Solution is Essential

Given these benefits, it is difficult for me to understand why Congress would pass legislation that creates insurmountable hurdles for new entrants and ideas. If, nevertheless, a majority in Congress wants to upset the status quo, Overstock believes that a fair legislative package must include the following elements.

1. First, because tax collection is really a duty of states and not retailers, the states should be required to provide a truly plug-and-play affordable software solution. Proponents of the pending legislation say such solutions are readily available in the marketplace, so this should not be a problem. The truth is, however, that they are not. I speak from recent experience at Overstock. We have been considering creating nexus in the state of Kentucky. In preparation for that event, we acquired what was described as an affordable plug-and-play software package that would ensure we were in compliance with the sales tax collection obligations for online sales to residents of the new jurisdiction. The off-the-shelf software required approximately \$300,000 of investment and months of man-hours of our IT staff to build. Implementation of this solution for the nation's nearly 10,000 different taxing jurisdictions would be extraordinarily costly for companies like ours. So if states want to tax our sales to their residents when we have no physical presence there, they should bear the cost of supplying the software.
2. Second, we should not be held liable to the states or to plaintiff law suits if errors arise from use of software solutions they provide, like missing a tax holiday, or a new tax rate, or the fact that one city in the state taxes candy while another does not.
3. Third, taxing authorities should compensate all retailers whom they require to collect sales taxes. There are significant costs associated with collecting and remitting the tax to the jurisdiction. Just as I cannot force my colleagues to work for free, states should not be allowed, in essence, to force-hire companies to do their work without expense reimbursement and some degree of revenue sharing.

In the event that Congress opts to end the status quo in favor of a federal solution for sales tax collection, Overstock has prepared the attached draft bill incorporating the principles that I have outlined. We believe that it should garner the support of the majority of E-commerce companies, as well as many bricks and mortar and bricks and clicks retailers, particularly smaller and mid-sized main street retailers who are otherwise hurt by the currently proposed bills.

Conclusion

Thank you, Chairman Smith, for inviting me to share Overstock.com's views on the sales tax issue. I truly appreciate this opportunity. I would be pleased to answer any questions you or Members of the Committee have. Overstock is eager to remain engaged in this debate.