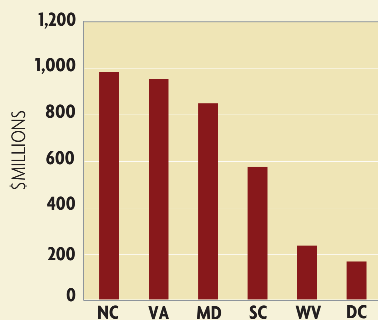
Internet Taxes

# Amazon Cuts N.C. Affiliates

**The latest battle over Internet taxation involved North Carolina and Amazon, the Seattle-based online retailer.**

In 1996, Amazon initiated the Amazon Associates program by which Web site operators, or "affiliates," earn money from product sales by posting ads that funnel customers to the parent site. Affiliates can earn anywhere from 4 percent to 15 percent of a product's price through this referral program.



SOURCE: Donald Bruce, William F. Fox, LeAnn Luna, University of Tennessee

In response to budget woes, legislators in North Carolina proposed adding a sales tax to out-of-state online transactions of businesses with a physical presence in the state. However, the state lost its opportunity to generate revenue when major online retailers, including Amazon, preemptively canceled agreements with North Carolina businesses in late June, a month before the tax was signed into law. In an e-mail to affiliates, Amazon announced it would discontinue its popular Amazon Associates referral program if the state's "unconstitutional tax collection scheme" passed.

North Carolina had previously required consumers to pay taxes on out-of-state purchases when they file their income taxes as a kind of "good faith" payment. But with most consumers either unaware of this tax or unwilling to pay, the state has lost approximately $145 million in tax revenue for 2008 alone. A legislative fiscal analysis projects up to an additional $13.2 million in fiscal year 2009-2010 on electronic commerce sales.

In 1992, the Supreme Court ruled that an out-of-state business must collect sales taxes only if a sufficient physical presence is established. Determined to reduce the Tar Heel State's $6.4 billion deficit, state legislators plan to force out-of-state businesses with North Carolina-based affiliates to begin collecting sales taxes.

Since these Web site operators, often small businesses, are based in North Carolina, the law defines Web site owners who run ads as a form of physical presence for Amazon and others, as if they had a warehouse or storefront. The "sufficient physical presence" clause would consequently mandate Amazon to collect taxes on behalf of the state.

Not only has the state lost the potential revenue from these Amazon sales, but a significant share of the residents who relied on the affiliate program for business will have less income to report.

Rich Owings, owner of a Web site that reviews global positioning systems and refers customers to Amazon and other online retailers, realized he would lose 40 percent of his income the day Amazon terminated its program. The outlook for his business looks grim, and he said that his options are to sell the business, move out of state, or let it go completely.

The Amazon issue foreshadows the larger problem of a tax system coping with rapidly evolving technologies, according to Bill Fox, director of the Center of Business and Economic Research at the University of Tennessee. One potential solution involves changing the federal sales structure, an initiative known as the Streamlined Sales Tax Project. It would create a uniform tax rate and define what constitutes a "physical presence" for online retailers.

Though the consequences for state tax revenues are uncertain, Fox says, this won't be the last time states will spar with online retailers over tax issues. Rhode Island, Hawaii, and New York have already passed such legislation, and more states may follow suit.

— CHRISTINA ZAJICEK

## Renter's Market
# Apartment Demand Declines

Springtime typically brings out the movers — people upgrade dwelling spaces or form new households, especially young graduates entering the work force. *Not this year.* With the housing market in a slump, you'd think more people would choose to rent. After all, homeownership has declined to rates not seen in nine years. But apartment vacancies nationwide have reached a 23-year high of 7.8 percent through third quarter 2009, according to Victor Canalog, director of research at Reis, Inc., a real-estate research firm.

In the Fifth District, year-over-year vacancy rates in Greensboro-Winston-Salem grew by 3.9 percentage points to 12.6 percent; rates in Charleston, S.C., stand at 12 percent, a change of 3 percentage points. Apartment vacancies in Richmond, Va., rose by 2.5 percentage points from the same quarter a year ago, and now stand at 8.2 percent. Charlotte, N.C., vacancy rates are 10.5 percent, a change of 3.3 percentage points over the same period in 2008.

The slow economy has staunched new household formation, dampening demand for apartments among the largest tenant group, 18- to 24-year-olds. While 1.6 million new households formed in 2007, according to the Census Bureau, that number fell to 772,000 in 2008. "Clearly we are seeing a pullback in new households formed," Canalog notes. "That is, basically, people leaving school and renting their own place."

And, although demand has fallen, supply is growing. About 73,000 units have come online through third quarter 2009, with the total expected at about 100,000 by year-end. "If you're a developer or lender obviously it's to your advantage to open your doors," Canalog says.

But there's another reason for the high vacancy rate: unsold houses and condos. "A growing shadow market is undercutting the traditional rental market," says Stephen Fuller, who tracks the trends for the Center for Regional Analysis at George Mason University.

Canalog notes that the continued high vacancy rate, which stayed above 6 percent through 2008, has given landlords no choice but to cut asking rents in addition to offering concessions. Asking rent nationwide has fallen by 0.5 percentage point from the previous quarter while effective rents, which factor in offers of gym memberships or months of free rent, have fallen by 0.3 percentage point. The first half of 2009 saw the biggest decline in asking rents since Reis began reporting quarterly data in 1999.

Fuller notes that the "distortion in the housing market will work itself out over time."

— BETTY JOYCE NASH

## Dwindling Blue Crab Populations
# Maryland and Virginia Offer to Buy Back Licenses

Too many crabbers with too many pots have prompted Maryland and Virginia to offer a voluntary buyback of state-issued licenses from some watermen. Maryland and Virginia have capped the number of crab licenses and limited harvests and seasons, among other measures, to cut harvest numbers and bolster the Chesapeake's puny blue crab population, which has fallen by about 70 percent since the 1990s.

PHOTOGRAPHY: MARYLAND DEPARTMENT OF NATURAL RESOURCES

Officials say that retiring the capacity for potential harvests will help stabilize the fishery. Licensees got the chance to submit a bid to the Maryland Department of Natural Resources (DNR) in July to show how much they'd be willing to pay to permanently give up the licenses. The state offer brought 494 bids among the approximately 2,000 licenses targeted. The DNR countered with a bid of $2,260 per license to all commercial license holders.

Virginia offered to buy licenses from both full-time watermen who averaged more than 100 days with pots (or 60 days in the case of juvenile pots, also known as "peelers") from 2004 to 2007 as well as part-time crabbers and people who were placed on wait lists for licenses in 2008.

It's unlikely that a full-time crabber would bid, but some watermen might be ready to retire, says Rob O'Reilly, a fisheries biologist with the Virginia Marine Resources Commission. "The crab pot and peeler pot fisheries — those together are getting 90 percent of all the harvest," he says, adding that's why they are attractive targets for buybacks.

Crabbers submitted a total of 665 bids to the Virginia Marine Resources Commission. Bids will be accepted or rejected by December 1. Once the state buys a license, it's permanently retired.

Virginia and Maryland in 2008 reduced allowable female catch by 34 percent, and the 2009 Winter Blue Crab Dredge Survey reported increasing numbers of year-old females.

— BETTY JOYCE NASH

Unemployment Trust Funds

## States Borrow to Pay Benefits

**At least 23 states and territories — including three in the Fifth District — have borrowed or will borrow from the federal government to pay unemployment benefits.**

In most states, taxes on employers fund unemployment trust funds. Employers pay taxes on a portion of each worker's salary, and those tax payments usually depend on the number of workers the firm has collecting unemployment. States with insolvent trust funds aren't collecting sufficient tax revenues to continue paying out benefits.

"I'm not surprised to see stress at the time of a severe recession," says economist Bill Conerly, a consultant and expert on unemployment trust funds.

The most troubled states are those with taxable wage bases that aren't keeping up with the growth in the economy, says Rich Hobbie, executive director of the National Association of State Workforce Agencies in Washington, D.C.

"The problem is really on the tax side," Hobbie says. "What we see historically in the system is the benefit side is a little better indexed to growth in the economy than the tax side."

Maryland is one state not borrowing to pay its unemployment benefits. Annual reviews determine the taxes that employers in the state will pay for the following year. "It's structured such that we hope to avoid borrowing federal money," says Tom Wendel, unemployment insurance assistant secretary.

At press time, the borrowing states and territories had received more than $17 billion in federal loans. Seven states have borrowed about $1 billion. Borrowing states won't face interest charges until 2011 under the stimulus bill.

North Carolina had borrowed more than $1.2 billion, according to the U.S. Department of the Treasury. The state started borrowing in February 2009 for the first time since 2003, says David Clegg, chief operating officer of the North Carolina Employment Security Commission. Before the current recession, North Carolina was working to rebuild its trust fund. "Had normal economic events occurred, we probably would have been OK — we have been in the past," Clegg says.

South Carolina has borrowed about $564 million, according to the U.S. Department of the Treasury. Virginia was scheduled to begin borrowing in October. The commonwealth won't see its unemployment trust fund solvent again until 2013, says Dolores Esser, commissioner of the Virginia Employment Commission. Virginia expects to borrow $1.23 billion.

This isn't the first recession during which states have borrowed from the federal government to pay unemployment benefits. In the late 1970s and early 1980s, there was a worse "borrowing crisis," Hobbie says. Larger amounts were borrowed, but they were paid back by the end of the 1980s. "I think to some extent as a nation we were lulled into a false sense of security in the 1990s," he says.

Employers will likely face higher taxes in the future as a result, Wendel says. "No matter what happens, to get the trust funds back up to what you would consider a good solvency level, employers are going to have to pay extra taxes over the next one, two, three, maybe even more years, depending on how long higher payouts occur." But in North Carolina, Clegg says it's going to be difficult to ask employers to cover a $1 billion shortfall.

Insolvency of state unemployment trust funds may have a small impact on hiring decisions, Conerly says. While taxes on employers fund benefits, ultimately employers don't foot the bill. "Virtually the whole tax is passed on to employees in the form of lower wages," he says.

— DAVID VAN DEN BERG