

Closing the Online Tax Loophole

The popularity of e-commerce has refocused the need to simplify sales taxes.



PHOTO CREDIT: MICHELLE BLACKSTON, NCSL

Steven Rauschenberger, former Illinois senator and NCSL president, right, testifies before the U.S. House Subcommittee on Administrative and Commercial Law of the Committee on the Judiciary in December. With him are Wayne Sakrzewski of the National Retail Federation and George Isaacson of the Direct Marketing Association. The trio shared their positions on H.R. 3396, the Sales Tax Fairness and Simplification Act.

BY MICHELLE BLACKSTON

Internet sales are a national phenomenon. Consumers spent \$136.4 billion on purchases they made online in 2007, a 19 percent increase over the previous year.

It's quick, it's easy, and in most cases you don't have to pay sales tax—a boon for the consumer, maybe, but a huge revenue loss for states.

Online business transactions have created a new economy not bound by local, state or international borders.

Michelle Blackston is NCSL's Public Affairs director.

“Electronic commerce has the potential to dramatically expand the volume of goods sold to customers without collecting sales or use tax,” says Steven Rauschenberger, former Illinois senator and NCSL president. “The shift to a service-based economy and the erosion of sales tax revenues from online sales threatens the future viability of the sales tax and the ability of state governments to fund such essential things as education, homeland security and public safety.”

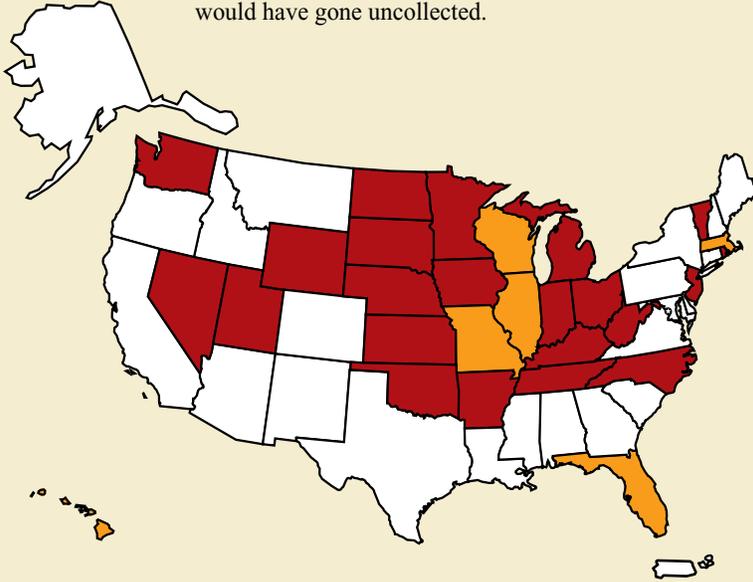
According to the U.S. Supreme Court, states' disparate state and local sales tax systems make collecting them an undue burden on out-of-state retailers. It ruled in 1967 that

states cannot force out-of-state businesses to collect taxes on remote sales and reaffirmed the decision in 1991. In fact, in the 45 states and the District of Columbia that have sales taxes (including 7,500 local jurisdictions, many of which also impose a sales tax), many tax the same items differently, making it confusing at best for retailers.

“The burden on retailers—literally and figuratively—to comply with 45 different sales tax systems is the reason behind the Supreme Court's ruling. It's just too costly and time consuming,” says West Virginia Delegate John Doyle. “Because states have not been successful in collecting the use taxes that

22 STATES HAVE SIMPLIFIED SALES TAX COLLECTIONS FOR RETAILERS

More than 1,100 remote sellers have voluntarily agreed to begin collecting sales taxes under a fairer and simplified sales tax system adopted by 22 states. So far they have remitted more than \$170 million in taxes that would have gone uncollected.



■ Compliant with the Streamlined Sales and Use Tax Agreement
■ Considering legislation

WHAT THE AGREEMENT DOES

The Streamlined Sales and Use Tax Agreement simplifies and modernizes sales tax collection and administration by adopting:

- ◆ Uniform product definitions, including definition of food and digital products.
- ◆ Uniform state and local tax base.
- ◆ State-level administration.
- ◆ Central seller registration.
- ◆ Uniform returns and remittance.
- ◆ Simplified exemption administration.
- ◆ Uniform audit procedures.
- ◆ Uniform privacy procedures.
- ◆ Notice requirements for rate changes.
- ◆ Uniform sourcing requirements.
- ◆ Telecommunications sourcing simplification.
- ◆ Uniform administrative definitions.
- ◆ Uniform rounding rule (computed to third decimal point).
- ◆ Elimination on caps and thresholds on sales.
- ◆ Uniform standards for sales tax holidays.

consumers legally owe when a sales tax is not collected by the seller, states are losing billions of dollars each year in revenue.”

Enter the Streamlined Sales Tax Project. In 2000, a group of state legislators, governors, tax administrators and representatives of the retail industry and business community set out to develop a simpler, more uniform and fair sales and use tax system. Their efforts culminated in the Streamlined Sales and Use Tax Agreement, ratified by delegates in 35 states in November 2002. Delegate Doyle serves as first vice president of the governing board for the Streamlined Sales Tax project.

In 2005, the agreement became operational when 13 states representing 20 percent of the U.S. population fully complied with the provisions.

Today, 22 states are complying with the agreement, and more than 1,000 remote sell-

ers have voluntarily agreed to begin collecting the taxes and so far have remitted more than \$170 million in revenue for states that previously would have gone uncollected.

“We have created a uniform and fairer system that removes the burden imposed on retailers, preserves state sovereignty, levels the playing field for all retailers and enhances the ability of U.S. companies to compete in the global economy,” says Representative Christopher Rants of Iowa “But we’re only half way to the goal. Now we need Congress to act.” Rants is co-chair of the NCSL Task Force on State and Local Taxation of Communication and Electronic Commerce.

As the simplified sales tax movement is gaining momentum (this year Florida, Hawaii, Illinois, Massachusetts, Missouri and Wisconsin have introduced legislation to comply with the agreement), federal legisla-

tion is making its way through both chambers of Congress. The Sales Tax Fairness and Simplification Act (H.R. 3396 and S. 34) would give states that have complied with the agreement authority to require out-of-state sellers to collect taxes on remote sales. Small businesses with less than \$5 million in out-of-state taxable sales would be exempted from the collection requirement.

A 2003 joint public-private study estimated that it cost retailers some \$6.8 billion to collect and remit state and local sales taxes, primarily because of the complexity and differences in how states administer and collect sales taxes. The agreement and the federal legislation would alleviate a sizeable portion of this cost.

“Sellers have told us that the real burdens with collection are not sales tax rates,” says Rauschenberger, “but the different product definitions from state to state, different state and local tax bases, and the different administrative rules and procedures.

“States have made unprecedented progress to eliminate these burdens and costs to retailers. Now Congress has the opportunity to ensure that states have a seamless collection of taxes in this new economy and preserve the competitive market.”



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