COMMITTEES: EXECUTIVE COMMITTEE TASK FORRCE ON STATE AND LOCAL TAXATION OF COMMUNICATIONS AND ELECTRONIC COMMERCE

COMMITTEE ON COMMUNICATIONS, FINANCIAL SERVICES & INTERSTATE COMMERCE

COMMITTEE ON BUDGETS AND REVENUE

POLICY: NEXUS IN THE NEW ECONOMY: ENSURING A LEVEL PLAYING FIELD FOR ALL COMMERCE

TYPE: DRAFT – Policy Statement

The 1967 *National Bellas Hess* Supreme Court decision denied states the authority to require the collection of sales and use taxes by out-of-state mail-order firms that have no physical presence in the taxing state, even though these remote vendors solicit and obtain significant sales there using the mail or common carriers.

In a decision (8-1) rendered by the U.S. Supreme Court in *Quill Corp. v. North Dakota*, U.S.S.C.Doc.No. 91-194, the Court confirmed the Commerce Clause portion of its decision in *National Bellas Hess, Inc. v. Dept. of Revenue,* 386 U.S. 753 (1967). The Court held that a mail-order company must have nexus with a state before incurring sales and use tax collection responsibility. By clarifying that the issue is purely one of Commerce Clause implications, rather than Due Process, the Court removed the barrier that prevents Congress from intervening. The majority opinion concludes by determining that Congress is the appropriate body to resolve the issue.

In 1994, the now defunct federal Advisory Commission on Intergovernmental Relations estimated that states lost about $ 3.3 billion per year in uncollected use taxes on about $58 billion in remote sales. In 1994, remote sellers primarily conducted businesses by mail and other traditional common carriers. While states requested Congressional assistance to overturn the *Bellas Hess* and *Quill* decisions, Congress lacked the political will to close this loophole in the state sales and use tax systems. Adding to the

Congressional indecision was a burdensome and complex system of sales and use tax collection laws and regulations which differed from state to state.

Cost of Collection

The sales tax is usually imposed on the customer, not the seller; states that impose the tax on the seller explicitly allow the tax to be passed through to the customer. Currently, sellers determine the sales tax to be collected, collect the tax and remit it to the state (in four states, Alabama, Arizona, Colorado and Louisiana, sellers also must remit the local portion of the sales tax directly to the local government). The seller also is liable for any mistakes that might occur due to misinformation from the buyer or even the state. This means that the seller is liable for any uncollected sales tax plus interest and penalties.

A recent national survey commissioned by the Joint Cost of Collection Study, a public / private sector group, and conducted by PricewaterhouseCoopers LLP, has shown that in fiscal year 2003 the total cost to sellers to collect state and local sales taxes was $6.8 billion. This amount was calculated after subtractions for state vendor discounts and retailer float on the sales tax revenues. The sponsoring organizations are: National Conference of State Legislatures; National Governors Association; Multistate Tax Commission; Federation of Tax Administration; Government Finance Officers Association; National Retail Federation; and, Council on State Taxation.

The study showed that for fiscal year 2003, for retailers selling between $150,000 and $1 million, the average cost was 13.47 percent of the sales taxes collected or approximately $2,386; for mid-size retailer with between $1 million and $10 million in sales, the average cost was 5.2 percent or approximately $5,279; and for the larger retailers, those with over $10 million in sales, the average cost of collection was 2.17 percent or approximately $18,233. It is important to remember that these amounts, including the total cost for all retailers of $6.8 billion, are not reimbursed to the retailer by the state or local government; these costs come out of the retailer’s own pocket.

The burden on retailers to comply with forty-six different sales tax systems and the monetary cost to retailers for compliance resulted in the two Supreme Court decisions, cited above, that prohibited a state from requiring an out-of-state seller from collecting sales tax on a purchase made by a resident of the state.

Challenge from the New Economy

Today, states face a new threat to sales tax revenue -- electronic commerce-- with the potential to dramatically expand the volume of goods sold to customers without collection of state and local sales or use tax. The combined weight of the inability to collect sales tax on remote sales through traditional carriers and the tax erosion due to electronic commerce threatens the future viability of the sales tax and essential governmental services such as education and public safety.

~~According to the report: "State and Local Sales Tax Revenue Losses from E-Commerce: Estimates as of July 2004" the Center for Business and Economic Research at the University of Tennessee, for 2006, the estimated combined state and local revenue loss due to remote sales will be between $19.2 billion and $26.5 billion. (The study was conducted at the request of the National Conference of State Legislatures and the National Governors Association.) For electronic commerce sales alone, the estimated revenue loss was between $10.4 billion and $14.0 billion. The report from the University of Tennessee further estimates that the revenue loss will grow and that by 2008, the revenue loss for state and local governments could be as high as $33.6 billion, of which it is estimated that $17.8 billion would be from sales over the Internet.~~ In April 2009, the Center for Business and Economic Research at the University of Tennessee estimated that the revenue loss due to all remote sales would be $23.2 billion in 2012, of which $11.4 billion loss would be from just electronic commerce. This amount will continue to grow proportionately each year as the amount of business to consumer transactions grows exponentially unless the states and Congress act to simplify and streamline sales tax collection.

Streamlined Sales and Use Tax Collection System

State legislatures have recognized that over the last seventy years, states have created a confusing, administratively burdensome tax system with very little regard for the compliance burden placed on multi-state businesses. In 1999, National Conference of State Legislatures, through the leadership of its Task Force on State and Local Taxation of Telecommunications and Electronic Commerce, acknowledged that states need to simplify their sales and use taxes and telecommunications taxes for the 21st Century.

To respond to the issues raised by the Supreme Court decisions, NCSL endorsed a set of principles to guide the simplification of sales and use tax collections systems. These principles are unique in that for only the second time in the history of the National Conference of State Legislatures, the Conference endorsed a set of actions for states to undertake. Those principles dealing with the sales and use tax collections systems are:

First, that state and local tax systems should treat transactions involving goods and services, including telecommunications and electronic commerce, in a competitively neutral manner; and

Second, that a simplified sales and use tax system that treats all transactions in a competitively neutral manner will strengthen and preserve the sales and use tax as vital state and local revenue sources and preserve state fiscal sovereignty; and

Third, that the Internet and Internet vendors should not receive preferential tax treatment at the expense of local "main street" merchants, nor should such vendors be burdened with special, discriminatory or multiple taxes; and

Fourth, that states recognize the need to undertake significant simplification of state and local sales and use taxes to reduce the administrative burden of collection; and

Fifth, that under such a simplified system remote sellers, without regard to physical presence in the purchaser's state, should be required to collect sales and use taxes from the purchaser and remit such taxes to the purchaser's state.

Since September of 1999, state legislators, governors, local elected officials, state tax administrators and representatives of the private sector have worked to develop the Streamlined Sales Tax Collection System for the 21st Century. In 2001-2002, 35 states enacted legislation expressing the intent of the state to simplify the state's sales and use tax collection system and to participate in multistate discussions to finalize and ratify an interstate agreement to streamline collection of the states' sales and use taxes. On November 12, 2002, those states unanimously ratified the Streamlined Sales and Use Tax Agreement, which substantially simplifies state and local sales tax systems, removes the burdens to interstate commerce that were of concern to the Supreme Court, and protects state sovereignty. The Streamlined Sales and Use Tax Interstate Agreement provides the states with a blueprint to create a simplified sales and use tax collection system that when implemented, allows justification for Congress to overturn the *Bellas Hess* and *Quill* decisions. Presently, all but one of the 45 states and the District of Columbia that levy a sales tax are involved in the process to streamline sales tax collection.

As of ~~July 2008, 22 states representing over 30 percent~~ May 1, 2011, 24 states representing over 35 percent of the total population of the United States enacted legislation to bring their state's sales and use tax statutes into compliance with the Agreement. On October 1, 2005, thirteen states with over 20 percent of the population were certified to be fully compliant with the Agreement and the system became operational. The efforts of these states and the other states still considering compliance legislation to erase the complexity and burdens of a 70-year old tax system on transactions so quickly is unprecedented in this nation's history.

Congressional Action

In less than six years, the states, working together with the support and assistance of the private sector, developed a new sales tax system that was fairer, simpler, more uniform and may be implemented technologically; ~~22~~ 24 states, almost half of all the states with a sales tax, enacted legislation to comply with these changes; and, the system is working. It is operational. However, the work to establish a truly seamless system is only half done. It is now Congress' turn to act.

Therefore, the National Conference of State Legislature calls upon the Congress to grant to those states that comply with the Agreement the authority to require all sellers not meeting the small business exception, regardless of location, to collect those states' sales and use taxes. Some have argued that businesses that are located in a state that chooses not to comply with the Agreement, or that has no sales tax, should not be subject to collection requirements under the Agreement, even though that seller chooses to sell into a state in which the legislature has decided to comply with the Agreement. However, no seller is forced to sell into states that comply with the Agreement. Out-of-state sellers make that decision and in doing so, they already make themselves liable to the state's other non-sales taxes statutes and regulations protecting consumers and conducting business. An out-of-state seller selling into a complying state will certainly make use of that state's legal system to collect unpaid costs from the consumer.

NCSL believes that this grant of authority by Congress to the states to require sales and use tax collection by all sellers not meeting the small business exception is indeed "fiscal relief," that ensures the viability of the sales tax as a state revenue source. NCSL further believes that Congress, in granting this authority to the states, will level the playing field between sellers and allow all transactions to be treated in a competitively neutral manner.

NCSL will support federal legislation to grant states collection authority that:

- Allows for a national *de minimis* or small business exception so that sellers with taxable remote sales below an appropriate amount would be exempt from collection requirements for those states in which they do not have nexus;
- Ensures reasonable and adequate compensation for the cost of collection;
- Applies the simplifications and grant of authority to transaction taxes on all communications services;

- Provides certainty to sellers by allowing an appeal process that includes review of the Agreement Governing Board's actions by the United States Court of Federal Claims; and,
- Ensures that any filings by sellers in the course of registering, calculating, collecting and/or remitting sales and use taxes collected cannot be used as a criterion for determining nexus for any other tax responsibilities, including state business activity taxes.

Business Activity Tax Reform

In this global economy, with more business being conducted by interstate companies, state legislators acknowledge the concerns raised by taxpayers frustrated with complying with different state business activity tax systems. The complexities of the various state business activity tax regimes coupled with the actions of aggressive state tax departments in enforcing these provisions has led to numerous legal challenges, that have cost state governments and the business sector vital financial resources.

The National Conference of State Legislatures has acknowledged the need to ensure that the tax administration and collection systems for sales taxes and taxes on telecommunications services are more efficient and strives to remove the burden of tax compliance from the taxpayer. NCSL believes that government must address the complexities of the current disparate business activity tax systems in order to reduce the complexities of tax compliance on the taxpayer and to maintain state sovereignty to levy business activity taxes. The National Conference of State Legislatures calls upon state and federal policymakers and taxpayers to enter into discussions that would lead to a fair and equitable tax on the business activity of interstate businesses in the states in which they have a meaningful presence.