

Ready for e-commerce?

BY KEON S. CHI

Most states rely heavily on sales/user taxes, which provide more than one-third of all state revenues. The 45 states with such taxes collected more than \$150 billion in 1998. Sales tax revenues largely finance K-12 education.

Currently, 34 of the 45 states with state sales/user taxes allow local governments to levy additional sales taxes to provide public services such as police and fire protection, transportation and health services.

State and local reliance on sales and use taxes faces an uncertain future, however. First, the sales tax base has shrunk steadily over the past three decades mainly due to a shift from taxable goods to services. In the 1950s, sales and gross receipts accounted for nearly 60 percent of state government revenues. The percentage decreased to 48 percent in recent years. In addition, mail-order outlets need not collect sales taxes from out-of-state customers, thanks to U.S. Supreme Court cases, such as *National Bellas Hess* (1967) and *Quill* (1992).

Now, the federal moratorium on taxing electronic commerce is threatening the future viability of the sales tax. Currently, revenue losses from not enforcing e-commerce taxation are relatively small. But most states are likely to lose millions or billions of dollars if they cannot collect taxes from rapidly growing e-commerce.

Thus, the issue is, can state and local governments afford to provide vital public services without raising more tax revenues from sources such as income and property taxes?

Mail order and e-commerce sellers complain about the complexity of complying with numerous state and local sales tax rates and rules. There are more than 7,000 sales tax jurisdictions with differing tax rates and inconsistent requirements across the states. The question is how can state and local governments achieve uniformity in their sales tax administration?

The National Tax Association, in a recent report, *Communications and Electronic Commerce Tax Project*, offers several solutions to the complexity and inconsistency of state and local sales and use tax laws. These solutions include each state having a single tax rate, uniform tax remittance and audit requirement forms, uniform exemptions for business purchases, and uniform definitions of

products and services. Several states are considering uniform sales tax structures on an intrastate and regional basis.

The NTA report cautions state policy-makers and tax administrators in implementing uniform taxes to pay attention to the potential revenue impact on local governments, small companies that cannot afford to comply with multiple tax jurisdictions, threshold requirements and sourcing (the ultimate destination of tangible products).

Related to tax complexity is the difficulty of tax compliance. Compliance is particularly difficult in e-commerce, where every seller is a multistate vendor. To reduce the burden of e-commerce taxation on remote sellers, state policy-makers might want to consider reducing the costs of compliance, tax returns and payments and tax audits.

They might also consider simplifying tax-rate monitoring and record-keeping requirements.

The NTA report offers options for reaching tax compliance. One option is base-state tax compliance, where the vendor would

file for registration, tax returns, tax remittance and audit only in one state. A second option is real-time tax compliance, where the tax would be collected and remitted to the states in real time, using point-of-sale equipment. A third option is simplifying the current system by adopting uniform forms for vendor registration and sales and use tax returns.

In a report, *Streamlined Sales Tax System for the 21st Century*, the seven national organizations of state and local governments, known as the Big Seven, promote several approaches to e-commerce and sales tax reform. These include: The elimination of administrative burdens of collecting sales and use taxes, a shift of sales tax administration to "trusted third parties," and the adoption of uniform legislation on e-commerce taxation either on a regional or national basis.

In summary, state policy-makers should provide a meaningful solution to sales tax problems by adopting some or all of reform measures before Congress acts.

Editor's note: For more information on e-commerce and sales tax reform, see *Electronic Commerce: Revenue Implications for States*, \$20, C200-9900, published by The Council of State Governments, P.O. Box 11910, Lexington, KY 40578, (800) 800-1910 or visit STARS at www.csg.org.



E-commerce requires a new look at sales and use taxes.

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