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A COMMISSION REPORT

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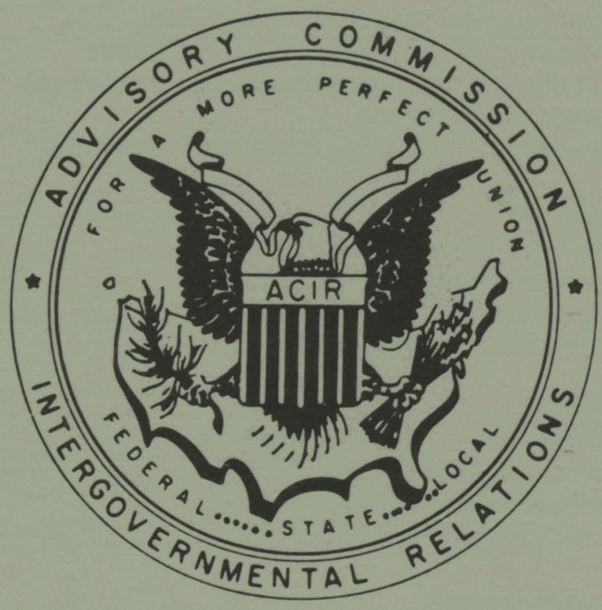
State And Local Taxation Of Out-Of-State Mail Order Sales



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A COMMISSION REPORT

State And Local Taxation Of Out-Of-State Mail Order Sales.

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PREFACE

State tax administrators have been unable to collect sales taxes from out-of-state mail order firms since the Supreme Court's 1967 National Bellas Hess decision. In that ruling, the Court held that out-of-state mail order houses could not be required to collect state and local sales and use taxes for states in which their only business presence consists of distributing catalogs and other advertising materials.

State tax authorities are now asking the United States Congress to negate the National Bellas Hess decision. This strategy is strongly opposed by many mail order firms on the grounds that they receive no direct benefits from the taxes which would be collected, and that they will be confronted with extraordinary compliance burdens.

What appears to be a fairly narrow conflict between tax administrators and mail order merchants is, in reality, another manifestation of the conflicts inherent in our federal system of government--a classic conflict between the national interest in protecting the free flow of interstate commerce from unreasonable imposition of state and local taxes, and the rights of individual states to protect the integrity of their taxing authority and their revenue system.

Members of the Advisory Commission on Intergovernmental Relations have long been aware of the festering nature of this conflict, and the philosophical and Constitutional issues involved. Before voting on its recommendation, the Commission held two public hearings, soliciting views from persons representing all sides of the question, and placed discussion of the matter on its docket for three meetings. On September 20, 1985 a majority of the Commission voted to recommend to Congress that legislation be enacted negating the National Bellas Hess decision by requiring mail order vendors to collect a state's use tax on interstate sales delivered in that state if the mail order vendor engaged in regular or systematic sales solicitation in the state. Because the Commission was keenly aware of the compliance costs which the recommendation would impose upon mail order vendors, particularly the small companies, it recommended that Congress ease these problems by incorporating a substantial de minimis provision and a single state/local tax rate provision in the legislation.

In making its recomendation, the Commission sought to strike a balance between the need to shield out-of-state mail order firms from undue compliance costs imposed by state/local sales tax authorities, and the need to prevent the erosion of the state/local revenue systems. Although the majority of the Commission members believed that the recommendation had achieved this end, five members of the Commission voted against it. Their strong dissent is set forth in this document.

Robert B. Hawkins, Jr.
Chairman

ACKNOWLEDGMENTS

Dr. Holley Ulbrich, senior academic resident in taxation and finance, was the author of this report. She had the assistance and advice of several members of the Commission staff, particularly Susannah Calkins, Robert Kleine, Michael Lawson, Karen Kirkwood, and Sarah Uhimchuk. The report was prepared under the direction of John Shannon, who was at that time the Kestnbaum Fellow of the Commission.

The assistance of many persons was invaluable in the preparation of the report; among those to whom particular thanks are owed are Leon Rothenburg of the Federation of National Tax Administrators, Sandra McCray of the Multistate Tax Commission, William Brown of the National Association of State Chambers of Commerce, Professor John Due, Charles Cadwell of the Small Business Administration, Billy D. Cook of the Washington, DC, Department of Finance and Revenue, and Karen Benker of the National Association of State Budget Officers. Others too numerous to name participated in the "thinkers" and "critics" sessions at the ACIR, provided assistance and information, and sent letters expressing their positions on the subject.

The Commission held two public hearings on taxation of mail order sales. At the hearings, testimony was presented by Jerome R. Hellerstein, adjunct professor of law at New York University School of Law; Robert J. Levering, director of government affairs and legislative counsel for the Direct Marketing Association; Harley Duncan, vice chairman of the Multistate Tax Commission; Paul A. Stinneford, vice president of Spiegel, Inc.; Robert M. Edmund, president of Edmund Scientific Co.; Roderick G. W. Chu, New York State Commissioner of Taxation and Finance; Thomas J. Little, president of Direct Order Sales Corporation; Ernest J. Dronenburg, chairman of the California State Board of Equalization; James L. Nelligan, Pennsylvania State Deputy Secretary for Taxation; Arthur W. Wheeler, president of the North Dakota Retail Association; David Certner of the American Association of Retired Persons; Charles J. Duffy, president of the Connecticut Retail Merchants Association; and David Nething of the National Association of State Legislatures. Statements were submitted by other interested parties.

As always, full responsibility for the content and the accuracy of this study rests with the Commission and its staff.

John Shannon
Executive Director

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Chapter 1

OVERVIEW AND POLICY RECOMMENDATIONS

Is it possible to shield interstate commerce from undue state tax burdens without causing serious tax losses for state governments? This tough balancing question confronted the Advisory Commission on Intergovernmental Relations as it sought to resolve a long-standing conflict over the taxation of out-of-state mail order sales.

The managers of the mail order houses contend that they should not be required to collect taxes on goods and services sold in those states where their only business presence consists of the distribution of sales catalogs or other advertising materials because they receive little or no benefit from programs financed by state and local sales taxes. Moreover, they argue that a Congressional directive that would force out-of-state mail order houses to collect the sales/use tax for all of the states and for thousands of local sales tax jurisdictions would impose heavy collection costs on them--an undue burden on interstate commerce.

In 1967, the Supreme Court, in the National Bellas Hess v. Illinois Department of Revenue decision,1/ supported their contention by ruling that states could not require out-of-state mail order firms to collect state sales/use taxes if their business presence in the state was limited to the sending of sales catalogs or other forms of advertising.

On the other hand, state tax administrators claim that the mail order industry has not cooperated with states by either collecting the tax or providing the state with the transaction data needed to bill customers for the tax. Thus, they argue that this situation provides out-of-state vendors with an apparent competitive advantage (4.5% average nationwide) over the millions of in-state merchants throughout the United States who can not legally avoid the collection of state and local sales and use taxes--a situation that undermines the fairness and equity of state-local tax systems.

State tax administrators also emphasize that this out-of-state mail order problem is bound to get worse because many factors are now contributing to the substantial growth in mail order sales--the use of television advertising,

"800" telephone numbers for placing sales orders, and other technological innovations such as the use of home computers for shopping and purchasing.

Most state tax administrators favor Congressional legislation that would negate National Bellas Hess by requiring out-of-state vendors to collect the use tax from their customers and remit it to the state revenue department.

BACKGROUND ISSUES

The Problem: Enforcement of the Sales/Use Tax Law

State tax authorities are becoming increasingly concerned about their inability to collect the sales/use tax in a growing number of cases in which their residents purchase goods from out-of-state mail order firms. Their enforcement concern is illustrated by the following hypothetical example in which three Wisconsin consumers purchased camping equipment for $1,000.

Consumer A buys at a local retail store where the firm collects $50 in Wisconsin sales tax and remits it to Madison.

Consumer B orders from the Sears catalog headquarters in Chicago. Because Sears also has outlets in Wisconsin (and hence a business presence), that firm collects and remits $50 in use tax.

Consumer C buys from a catalog seller in Maine which has no business location or facilities in Wisconsin. He pays neither sales nor use tax.

The point must be emphasized that Consumer C is legally liable for the payment of the Wisconsin use tax on the equipment he purchased and had sent into the state. The only issue is how to best collect the sales/use tax.

Vendor Collection

Sales and use taxes are levied on the final purchaser but collected primarily through the vendor.2/ For in-state sales, the fact that the sales tax normally rests on the purchaser but is collected by the vendor presents no serious problems. For many interstate sales, the state is also able to collect use tax through one of following methods:

1) If the vendor has an adequate "nexus," i.e., business location or other identifiable linkage which meets the nexus test--warehouses, retail outlets, salesmen, offices, service facilities, etc.--in the state, the state is able to require that the firm collect either sales or use tax, usually the latter.

2) Out-of-state purchases of automobiles are usually subject to collection of sales or use taxes because the purchaser must pay it in order to register the vehicle in the state.3/

3) At least part of the use tax on business purchases from out-of-state vendors can be collected from the business purchaser through normal channels (monthly or quarterly sales tax returns) or on audit by state tax authorities if the purchaser is registered for sales tax purposes.

4) State reciprocal cooperative collection agreements provide for some use tax collection, although this is the least common method, particularly since the National Bellas Hess decision.

Purchases on which the use tax is most likely not collected include mail order and direct marketing interstate sales, border sales, and some part of taxable business-to-business sales. It is the first of these categories, and some parts of the third category, which are treated here.

Recognizing that the obligation to collect sales and use taxes is not costless to the vendor, 25 sales tax states now offer some kind of collection cost allowance to firms collecting the tax. While Michigan provides only a flat $50, Kentucky allows only 1.25% of tax collections up to $1,000, and Utah gives only a breakage allowance,4/ the other 22 offer a percentage of tax collected, ranging from 1% in five states to 3.3% in Colorado. A small number of states have a sliding scale percentage with a larger allowance for small firms.5/

The Size of the Mail Order Industry and Its Potential for Growth

The amount of revenue lost by states and the competitive effects on in-state firms from these nontaxed interstate purchases depend on the size of the mail order and direct marketing industry. It is very difficult to determine precisely how large sales volumes are. Mail order and direct marketing are not a separate "industry" but a branch of retail trade; there are many small firms and high levels of entry and exit from the field, a general characteristic of retail trade. Estimates of sales by mail order firms range from the Census' very conservative $11.1 billion in 1982 6/ to the industry's own figures of sales well in excess of $100 billion in 1984.7/ Census data only includes those firms for which mail order is the primary industry (SIC 5961); the Small Business Administration data base suggests that at least half of mail order sales is attributable to firms with a primary classification other than mail order sales, mostly retail firms with a "sideline" in mail order. The "big

three"--Sears, Penney, and Ward--would be found, for example, in a different SIC category since operation of general merchandise stores is their primary business and generates far more volume than mail order.

One rather careful 1983 estimate (by Arnold Fishman) sets consumer mail order product purchases at $30.8 billion and business mail purchases of products and services at $28 billion.8/ A portion of business purchases is subject to use tax, much of which goes uncollected; ACIR uses an estimate of 25% or $7 billion. The highest sales figures for the industry (those in the $100-billion-plus range) are often based on multiples of advertising or other shortcut methods, and usually include such nontaxable categories as services and charitable fund-raising by direct mail. Thus, the intermediate estimate of $37.8 billion in potentially taxable mail order sales for 1983, or about $44.9 billion in 1985, based on recent average growth rates of mail order sales, is used as the starting point for the ACIR revenue estimates. This figure is close to the range suggested by Census when account is taken of industries with a secondary business in mail order, business mail order purchases, and a three-year projection from 1982 to 1985, all of which would give an adjusted Census figure for 1985 of $36 billion.

Mail order sales have been growing somewhat more rapidly than GNP or total retail sales--at a rate of 9% a year in the Census estimates for 1972-82, and currently at a rate of 8-12% a year according to intermediate estimates. As a result of recent technological changes in communications, some observers expect sales by this method to grow rapidly in the near future. These technologies include the growing use of toll-free "800" telephone sales through newspaper, magazine, and television ads; the infant computer marketing via home computer linkup; and new developments such as computer terminal "catalogs" for direct sales placed in factory cafeterias, supermarkets, and other strategic locations. Other observers are less sanguine about industry prospects; they point out that a number of catalog sellers failed during the 1982 recession. Because of the difficulty of forecasting the industry's future, we are limiting tax revenue estimates to the near term.

Effects of Industry Growth on Competition and Tax Revenue

The side effects of past and prospective growth in mail order sales are twofold; the impact of tax-free mail order competition on in-state retailers, and the potential state and local tax revenue loss.

Competitive Effects. The consumer's decision to purchase from an out-of-state firm may be motivated by many factors. Avoidance or evasion of the sales or use tax is frequently not the primary or even a major reason for choosing mail order rather than a local retailer.9/ However, price differentials resulting from the lack of sales taxes can sometimes create a marginal advantage for an out-of-state supplier who does not have sufficient business presence in the state to be required to collect use taxes. This tax advantage is particularly important for "big ticket" items--furniture, recreational equipment, computers, and audio equipment.

Consider the simple example cited above. The purchaser of $1,000 worth of camping equipment, who resides in a state with a 5% sales and use tax, might consider three suppliers. The in-state firm must collect 5% ($50) in sales tax. The large mail order firm, such as Sears, meets the linkage requirement and must collect $50 in use tax. Firm C is a mail order firm in another state with no business presence in the customer's state. By purchasing from Firm C, the buyer can avoid the sales tax and evade the use tax. Other things being equal, the knowledgable purchaser will lean toward Firm C.

An out-of-state seller's tax-based competitive advantage has both efficiency and equity aspects. Economic efficiency implies that consumers should be choosing suppliers on the basis of total cost and benefits, taking into account transaction costs, service, price, etc., but should not be induced to select a supplier by tax differences. Tax advantages for out-of-state vendors distort consumer decisions and encourage expansion of the mail order industry relative to other types of retail suppliers. In equity terms, the amount of sales and use tax paid by a particular consumer should not depend on his or her choice between an in-state retailer and an out-of-state mail order supplier.

State and Local Government Revenue Losses. Even if evading the use tax is not always the primary motive for preferring out-of-state mail order to local retail outlets, the effect on the state and local tax base and sales tax revenue is the same--a loss of revenue because of inability to collect the use tax. Chapter 2 develops 1985 estimates of revenue losses in the $1.4 to $1.5 billion range by state governments and by those county or municipal governments with local sales and use taxes. These estimates are based on the Fishman sales data with careful adjustments for exempt items and other corrections. If corrective legislation were enacted even after allowing for vendors that meet the linkage

test in multiple states, or exclusion of some sellers by a *de minimis* rule exempting firms below a specified sales threshold, total state and local sales and use tax revenues gains in excess of $1 billion seem well within the realm of probability.10/

Growing Dependence on Sales Taxes

Growing state reliance on sales and use taxes has compounded the amount of revenue loss from interstate mail order sales. Sales and use taxes constitute 24% of all tax revenues for state and local governments in 1982, up from 19% in 1967 (the year of the *National Bellas Hess* decision). From 1979-85, the number of local jurisdictions levying sales taxes grew by 22%, from 5,448 to 6,668. In addition, 26 states had higher sales tax rates in 1985 than they had in 1980, while only one state had a lower rate.11/

Compliance Costs--The Business Side of the Story

Firms not now obligated to collect the tax rest their economic arguments against collection requirements primarily on compliance costs. If local as well as state use taxes are to be collected (both are collected by mail order firms meeting current nexus standards), there are nearly 6,500 jurisdictions to deal with; even for state taxes alone, or a combined state-local tax, there are 46 jurisdictions. In addition to rate differences, exempt items and buyers vary greatly from state to state--a particular problem for sales into states exempting purchase of food and clothing, or to potentially exempt buyers (e.g., charitable organizations in many states), or to business firms.

Mail order firms argue that an adequate determination of the sales tax is more difficult in mail order purchases without the physical presence of the customer to resolve borderline cases of exemptions. The mail order customer who pays cash must determine the amount of tax and add it to his payment. The growing volume of credit purchases eliminates this problem, because the mail order house determines the tax owed.

Compliance costs appear to be a particularly serious problem for the numerous small firms who do not account for the bulk of the sales in mail order and direct marketing. The definition of "small" is a critical component of any proposed legislation. A Philadelphia firm which sells sales and use tax computer software estimates that annual sales of $5 million would be a threshold level for use of their product, a measure which ties size to use of cost-saving

tax compliance technology.12/ The Small Business Administration develops size standards for various industries which define maximum sales levels below which firms are eligible for the services of the SBA. For mail order firms (SIC 5961) the 1984 threshold sales volume was set at $12.5 million.

Large firms are more likely to meet the business presence test in more than one jurisdiction and therefore have greater familiarity with complying with multiple sales and use tax requirements than smaller firms. Few firms, however, are presently involved in collecting taxes for a large number of states. A rough measure of those who meet the nexus requirement in more than one state is the number of multi-establishment firms. Census data indicates that in 1982, only 18 of 5,858 firms which list mail order as their primary classification operated five or more establishments.13/ (No comparable firm/establishment data are available for firms whose secondary industrial classification is mail order.)

Several possible solutions to the compliance cost problem have been proposed. These include a national mail order tax on interstate mail order sales at a single uniform rate, to be remitted to the states; limiting collection to state sales and use taxes only, thus reducing the number of rates to 46; universal collection cost allowances; taxation of mail order sales by state of origin rather than state of destination; or exemption of small firms through a *de minimis* rule. No action on taxation of interstate mail order sales should be undertaken without addressing the issue of compliance costs for small firms.

Congressional Inaction--
The Corporate Income Tax Linkage Problem

For 25 years, states have sought to broaden the array of firms liable to collect state sales and use taxes. These actions have been effectively countered by business efforts to restrict the jurisdictional reach of the state corporate income tax with respect to multistate and multinational corporations. In a series of hearings on these two interrelated but separable issues, the early discussions focused on the sales and use tax. Recent hearings have given more time and attention to worldwide unitary corporate income taxation. During the same period, the jurisdictional reach of the use tax has actually been narrowed by several Supreme Court decisions, of which *National Bellas Hess* in 1967 was the most significant.

As the national government attempts to devolve some of its responsibilities

to the states, and as federal aid becomes a smaller fraction of state and local resources, it is particularly appropriate to reexamine the restrictions on the ability of states to raise revenue from the sales and use tax--a traditional mainstay of the state government tax structure in 46 of 51 jurisdictions.

Previous Commission Action

Although this analysis is the first thorough study that ACIR has done of the interstate mail order use tax issue, the Commission did adopt a recommendation on the topic in 1974 as a part of the Local Revenue Diversification study.14/ That recommendation called for federal legislation to ease compliance problems for out-of-state vendors and to protect in-state businesses from tax-free competitors by authorizing states to collect sales taxes on firms making sales in states in which they have no place of business. The broad 1974 recommendation, unlike the one in this study, would imply that border firms and mail order firms both would have a collection obligation. (The text of this previous recommendation is reproduced in Appendix A of this study.) The current study and recommendation are limited to mail order and direct marketing sales.

In 1981, the Commission considered the issue of unitary state taxation of corporate income.15/ Recommendations pertaining to the jurisdictional reach of the sales and use tax were presented to the Commission for consideration in conjunction with that study. However, no Commission action was taken on this issue. (That proposed recommendation is also included in Appendix A.)

FINDINGS AND POLICY CONCLUSIONS

In addressing the problem of how best to collect sales and use taxes owed by a purchaser of goods from an out-of-state mail order house, the following major findings and policy conclusions were reached.

1. Minimum Linkage--the "Nexus" Test

The requirement that a tax collection obligation could be imposed only on out-of-state firms which meet some test of some minimum linkage (business presence test) with the taxing state was established in the majority opinion in the 1967 National Bellas Hess decision. Because the decision was made in an era of more traditional sales methods, the definition of nexus should be reviewed in the light of the increased use of sophisticated means of communication requiring no physical presence, such as direct computer access, specialty cata-

logs, and computerized selection of mailing lists, toll-free "800" telephone numbers and television advertising of direct marketing sales. Ordering by mail from catalogs, the issue in National Bellas Hess, is now only one of a number of sales methods not requiring a physical presence or direct face-to-face contact with the buyer.

2. Available Remedies

Past Supreme Court decisions limit the ability of states to resolve this issue solely by means of voluntary compliance or interstate cooperation in enforcement. Using state courts to seek judgments against noncomplying firms, as the State of Illinois attempted to do in the 1967 case, at best, would bring only a very limited additional portion of interstate mail order sales into the taxable domain, given the existing Court decisions which limit the reach of interstate cooperation to firms meeting current nexus standards. Litigation by states in federal courts to broaden nexus and to consider new forms of communication and new sales methods as a basis for reconsideration and redefinition of nexus is a possible remedy. However, it also may cover only a portion of mail order sales. Federal legislation restoring the pre-1967 situation, or alternatively, imposing a national tax on currently untaxed interstate mail order sales, is a more inclusive but also more intrusive potential remedy than either cooperative or judicial approaches. All of these remedies were considered by the Commission in the 1985 hearings and deliberations on this issue.

3. The Interstate Commerce and Due Process Clauses

Legal opinion shows some division on whether Congress is Constitutionally able to overrule the Supreme Court and modify or discard the narrow nexus stan-standard in National Bellas Hess. Attorneys for mail order interests contend that Congress is powerless to act; they argue that, because the majority decision rested on the Due Process Clause of the Constitution, the clearly delineated authority of Congress to regulate interstate commerce does not extend to overturning a due process decision. Lawyers representing state interests do not feel that due process considerations constitute an insurmountable barrier to Congressional action. They point out that the National Bellas Hess decision was based primarily on Commerce Clause concerns and that the Due Process Clause has been described by the Court as "an elastic concept." In addition, they point out that the jurisdictional standards presently governing state corporate income

taxes came about as the result of Congressional action in 1959 to overrule a Supreme Court decision that same year (Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450). Finally, they suggest that Congress' power in due process, spelled out in the 14th Amendment, has often been used to expand due process; it is not clear why Congress could not also restrict due process, especially in the context of federalism rather than civil rights.

4. Methods of Enforcement

If federal legislation extended the linkage standards so that a substantial number of nonresident mail order firms could be required to comply with use tax collection requirements, several methods of enforcement would be feasible. The weakest but also least intrusive method is to return to the method of enforcement attempted in National Bellas Hess--voluntary cooperation between the vendor's state and the purchaser's state. A stronger method is for Congress to authorize multistate reciprocal agreements to enforce collection of the use tax. A third, far more effective method, but one that would also substantially increase federal participation, is to authorize enforcement through the federal court system. Finally, some industry sources have suggested that compliance costs might be minimized with a federal mail order sales tax on all sales outside the state(s) in which the firm meets current linkage standards. The funds could then be distributed among the states on the basis of a criterion such as population size, share of total retail sales, or personal income. While this last solution involves the greatest federal intrusion, it is also the enforcement method with the lowest collection/compliance costs for firms.

5. Economic Effects: Competitive Aspects and Tax Revenue Losses

Economic theory predicts that failure to impose sales and use taxes on nonresident mail order firms would affect sales of competing in-state firms, whose sales are subject to sales tax, as well as sales of competing mail order firms which meet the linkage test and must collect use tax. The National Bellas Hess decision may in fact be partly responsible for stimulating the growth of the mail order industry by creating tax incentives to expand interstate mail order selling.

The large volume and rapid growth of interstate mail order sales, much of which escapes state and local use taxes, have generated substantial losses of

state and local sales and use tax revenue. Estimated revenue losses from the inability to collect sales and use tax on most mail order and direct marketing sales in 1985 range from $1.4 billion to $1.5 billion.

6. Compliance Costs and Double Taxation

Because of the high compliance costs associated with collecting taxes for multiple jurisdictions, business firms engaged in interstate mail order sales object to proposals to require them to collect and remit the use tax. Differences in rates and exemptions as well as about 6,5000 state and local jurisdictions imposing sales and use taxes contribute to high compliance costs.

Mail order firms also argue that nonuniform state credits and refunds for taxes paid to other states can lead to double taxation. Although coverage and other aspects still vary greatly from state to state, in the last two decades states have made progress in making their sales and use taxes more uniform with respect to providing credit and/or refunds for sales and use taxes paid to other states.

Possible approaches to addressing compliance costs include: (1) a _de minimis_ rule (exempting firms with sales below a certain threshold), (2) a uniform combined state and local rate for each state, (3) allowing collection of state use taxes only (not local), or (4) wider state use of percentage allowances to cover collection costs. Empirical evidence suggests that compliance costs are particularly a concern for small firms. If a _de minimis_ rule is adopted, the choice of an appropriate threshold would have to be based on carefully weighing the revenue and competitive considerations against the compliance costs. Data from the _1982 Census of Retail Trade_ suggests that the industry is dominated in numbers by small firms but in sales by a few large firms. Using Census data on the size distribution of firms listing mail order as their primary industrial classification in 1982, a threshold of $5 million in gross sales would have exempted 96% of the firms but would still have covered 76% of the sales. A similar size distribution appears to hold for firms with mail order as a secondary industry, based on employment data; of the 1,670 firms in this category, 1,417 (85%) had fewer than 20 employees and would in most cases fall below a $5 million threshold. Of course, other thresholds can also be considered. For example, a $10 million threshold in gross sales would have exempted about 97.5% of the firms in the primary classification and still have covered 70% of the sales. In the absence of other standards, a reasonable suggested standard for

protection of small firms is the sales level below which firms in the mail order industry are eligible for the services of the Small Business Administration. In 1984, that figure was $12.5 million in sales for mail order firms. Census data on size of firms are not available for that threshold; obviously, the number of firms that it would exempt would be even larger than for a lower threshold.

7. "De-Linking" Sales and Income Taxes

The long period during which Congress has linked the jurisdictional reach of state and local sales and use taxes to that of the state corporate income tax has been a handicap to bringing about any kind of change in either. This linkage, which antedates National Bellas Hess, has frustrated remedial action in the past; any legislation aimed at modifying the nexus standards of National Bellas Hess should not be dependent on the fate of efforts to impose Congressional restrictions on how states tax the incomes of multijurisdictional firms.

8. Timeliness

Several factors suggest that the time is appropriate for Congressional action. The issue of worldwide unitary corporate income taxation, to which the jurisdictional reach of the state sales and use tax has been linked in the past, shows signs of approaching resolution. Recent reductions in federal grants to state and local governments, as well as continuing efforts to devolve responsibilities to states, place additional fiscal pressures on state and local financial resources. Congress could mitigate some of the fiscal impact of cutbacks and devolution by relaxing court-imposed restrictions on the ability of states to collect sales and use tax revenues.

COMMISSION RECOMMENDATION

At its September 1985, meeting, the Commission considered four alternative recommendations relating to collection of sales and use taxes on out-of-state mail order sales. The Commission recommended enactment of federal legislation to enable states to require the collection of use taxes on interstate mail order sales without reference to nexus requirements. It favored enabling federal legislation because of the serious drawbacks to be found in each of the three other alternative approaches:

- o to affirm the status quo;

- o to encourage state-initiated litigation to overturn National Bellas Hess; and
- o to recommend Congressional legislation providing for a direct federal tax on mail order sales across state lines.

The Commission found affirmation of the status quo unsatisfactory because the problems caused by the existing situation are too serious to be ignored. Compliance problems plague state tax administrators, who have no way of assessing or collecting use taxes on many mail order purchases coming into their state. Because of the problems in collecting sales and use taxes on mail order sales, state tax administrators find that the integrity of their tax base is being undermined, and that severe damage has been done to the perceived equity of their tax system. In-state merchants feel that they are placed in an unfair competitive position compared to many out-of-state mail order houses who do not collect sales/use taxes.

The Commission rejected the alternative recommendation that states actively pursue litigation intended to modify or overturn the nexus standards established in the National Bellas Hess case, and, if successful, then implement collection of use taxes on interstate mail order sales through multistate cooperative agreements. This alternative was found to be unsatisfactory because litigation addresses the problems in a piecemeal fashion, requiring a long series of court decisions to resolve the issues involved; the litigation process has no possibility of addressing the political-administrative problems involved in taxing mail order sales, such as compliance costs or the multiplicity of state-local tax rates; and even successful litigation cannot resolve most enforcement problems.

The Commission was also presented with a third alternative--to recommend enactment of federal legislation imposing a federal mail order sales tax at a single rate on all sales to customers outside the state in which the mail order firm is located. Although the relative simplicity and minimal compliance costs for the seller are attractive, the Commission could not endorse a direct federal tax because it would represent a major federal intrustion into state taxing authority. It would impose sales and use taxes on mail order sales in states which do not presently levy such taxes on in-state sales, putting mail order houses at a competitive disadvantage in those states.

The Commission chose to recommend corrective federal legislation negating the National Bellas Hess decision and thereby enabling states which have sales

and use taxes to enforce use tax collection. This solution offers the most direct and comprehensive resolution of the issues of competitive fairness, tax revenue, and compliance costs without requiring drastic federal intervention. Federal legislation would define nexus standards (the degree of business presence needed to require collection of use tax) clearly and uniformly in all situations at the same time.

In sharp contrast to a judicial solution of the problem, Congressional action could weigh a broader business presence standard against legitimate business concerns about compliance costs and protection for small firms. Business interest in a de minimis rule, uniform state-local rates, and amnesty for prior taxes could be addressed in legislation. All of the economic issues--tax revenues, competition, and compliance costs--could be resolved through appropriate legislation.

Legislation could also address the current problem of enforcement. State officials feel that a central issue is the uniform enforcement of a clearly established use tax liability in order to promote tax fairness as well as to prevent further erosion of the sales and use tax revenue base. The sales and use tax is the only broad-based tax which is primarily if not exclusively available for state government since property taxes are primarily local, and the federal government makes intensive use of the individual income tax. Thus, its perceived fairness and the integrity of its base should be safeguarded.

Critics may argue that corrective federal legislation would involve action by Congress to reverse a long-standing decision of the Supreme Court. They point to legal disagreement as to whether it is possible for Congress to overrule the National Bellas Hess decision. However, the Supreme Court decision in National Bellas Hess invited Congressional action. If the action taken by Congress is felt by some to be inappropriate, it can be tested through subsequent litigation.

Both proponents and critics of federal legislation overturning the National Bellas Hess decision recognize that resorting to a federal legislative solution involves a risk of restoring the linkage in Congressional action between state corporate income taxes and sales and use taxes. The legislative process may not be costless to state revenue officials. To put the issue more bluntly, the price that states may have to pay for Congressional help in extending the reach of their sales/use taxes may be some real constriction on state jurisdictional reach in the corporate income tax area. However, the sales and use tax is a

much more significant revenue source for most states than the corporate income tax, and the prospective tax revenue losses from proposed changes in the latter are far outweighed by the potential revenue gains from being able to collect use tax on interstate mail order sales.

With these considerations in mind, the Commission adopted a recommendation for corrective federal legislation to enable states to enforce use tax collections on out-of-state mail order sales:

The Commission recognizes that significant changes have occurred in the composition and technology of the retail sales market in the 18 years since National Bellas Hess. It is also keenly aware of the need to equalize the competitive position of in-state and out-of-state vendors and to safeguard state sales and use tax bases and revenues. To achieve these aims, the Commission recommends that Congress enact legislation that would negate the National Bellas Hess decision by requiring mail order vendors to collect a state's use tax on interstate sales delivered in that state, if the mail order vendor engages in regular or systematic solicitation of sales in that state through catalogs, advertising, or other means.

To relieve the compliance cost burden on small businesses, the legislation should contain a de minimis rule, exempting vendors with national sales and/or sales in the destination state below a specified threshold dollar amount. The de minimis figure(s) should be determined by Congress, but should be no less than $12.5 million in gross sales, indexed annually to the Consumer Price Index to account for inflation.

To minimize compliance costs for firms operating in multiple jurisdictions, states in which there are local sales and use taxes should determine a nondiscriminatory single rate, either (a) the state rate only or (b) a combined state and local rate that the out-of-state seller may elect to charge in lieu of applying the combined state and local rates for all jurisdictions which are the destinations of the sales.

To protect firms from indeterminate tax liabilities for past sales, no state should be allowed to collect any additional taxes based solely on retroactive application of any Congressionally authorized modification of nexus standards.

Exemption of Small Mail Order Firms from Use Tax Collection Requirements

Empirical evidence indicates that the cost of complying with the requirement that use taxes be collected on out-of-state mail order sales is highest for small firms which have great difficulty in keeping abreast of the rates and exemptions applying to the 45 states and about 6,500 local governments which impose sales/use taxes. These firms are frequently too small to be able to afford the computerized equipment which would make the task feasible. Even from the

stand-point of the state tax administrator, it is cost effective to exempt small firms and thereby reduce the state's collection costs in collecting small sums through a large number of out-of-state vendors. While there are a large number of firms in the mail order segment of retail sales, a small number of large firms generate most of the sales volume. Thus, tax revenue could be collected on a large proportion of mail order sales by having tax collectors deal with a relatively small number of registered sellers. The Commission recommends that legislation should contain a de minimis rule, exempting vendors whose national sales and/or sales in the destination state are below a specified threshold amount.

While the Commission recommends that the de minimis exemption should be determined by Congress, it suggests that the national level should not be less than $12.5 million indexed annually to the Consumer Price Index to account for inflation. The Commission chose the figure of $12.5 million because the Small Business Administration considers firms in the mail order industry eligible for assistance if their 1984 gross sales are below that level; thus, this level is the accepted government standard for defining a small business in the mail order industry. Although figures are not available to indicate the number of firms which would be exempt at the $12.5 million level, information indicates that only 3.8% of the firms with mail order as their primary or secondary industry classification would be required to collect the tax if the de minimis exemption were set at $10 million. At the $12.5 million level, the percentage of firms subject to collection requirements would be somewhat lower.

While objections have been raised to the exemption of small firms on the grounds that small in-state firms enjoy no such sales tax exemption, in many of the states imposing sales and use taxes, the compliance cost burdens for small in-state firms are eased by collection cost allowances which cover some part of the collection cost. A useful supplement or alternative to a de minimis rule could be to require all states to provide a collection cost allowance for collection of interstate sales and use taxes.

Single Rate Provision

The Commission recommendation also provides another way of easing the cost of compliance for mail order firms--a single tax rate for each state. It is time-consuming and costly for a mail order house to be required to determine tax rates for purchases in every sales tax jurisdiction in the United States--as

many as 45 state rates and about 6,500 local rates are potentially involved.

The Commission recommendation attempts to ease this compliance burden by providing that in states in which there are local sales and use taxes, the state should determine a nondiscriminatory single rate, either the state rate only, or a combined state and local rate, which the out-of-state seller may elect to charge in lieu of charging the combined state and local rates for each involved jurisdiction. This provision would reduce the number of rates facing a multistate firm to a maximum of 46.

Admittedly, the process of determining a combined state-local rate is difficult in those states where local rates are nonuniform and the use of local sales taxes is limited to certain jurisdictions. It might be preferable to limit use tax collection to the state tax. There is strong precedent for excluding local use taxes from federal legislation because they are not currently enforced on in-state purchases--a purchase made in City A in Ohio with no local sales tax would not be assessed for a local use tax in the purchaser's home City B when the item is brought home. On the other hand, much potential tax revenue may be lost by excluding local taxes. For example, New York City has a local rate which is higher than the state rate, and a significant volume of mail order sales can be presumed to be made to the residents of that city.

Amnesty

The Commission's recommendation for an amnesty provision is designed to protect firms from indeterminate liabilities for back taxes. It would be particularly important for small firms if the proprietor wished to sell the firm or issue stock or debt. The provision would free mail order firms from the spectre of an indeterminate contingent liability for sale or use taxes on past sales.

In summary, the Commission's recommendation for dealing with the problems posed by the mail order issue seeks to strike a balance between two conflicting and perennial concerns of the federal system--the maintenance of a free flow of interstate commerce and the retention of strong state revenue systems. In response to interstate commerce concerns, the Commission required safeguards designed to minimize the compliance burdens on out-of-state mail order firms. In protecting the integrity of state revenue systems, the recommendation enables the states to collect more than 70% of the estimated $1.5 billion which currently escapes sales taxation, while exempting some 6,000 mail order firms nationwide.

In the judgement of the majority of the Commission, only carefully crafted Congressional action can both negate the National Bellas Hess decision and acheive a delicate--but essential--balance.

DISSENT FROM MAIL ORDER SALES RECOMMENDATION

Chairman Robert B. Hawkins, Jr.,
Attorney General Edwin Meese, III, Secretary William E. Brock, III,
Governor John H. Sununu,
James S. Dwight, Jr., and Kathleen Rothschild

The Commission's recommendation in this report is one of short-sighted expedience for state governments. Regrettably, it harbors long-term erosion of state taxing authority, and is devoid of circumspection, consistency, and Constitutional soundness. We therefore dissent from this recommendation, and strongly believe that enactment of such legislation would violate the basic precepts of American federalism.

Lack of Circumspection. States should be acutely aware of the potential consequences of asking Congress for help in tax collection. The price of legislation to extend the reach of the state sales tax collector may turn into constraints on the ability of the states to collect corporate income tax.

For years, representatives of business firms have been urging Congress to place a variety of restrictions on state use of corporate taxes. Perhaps the most notable example is the proposal to prohibit unitary taxation--a method by which all corporate profits are computed in determining taxes owed a state. In opposing a ban on this taxing method, state officials, particularly tax administrators, have quite properly defended the inherent right of states to use whatever method they believe fair in assessing the tax liabilities of corporations. The claim of business that unitary taxation is inefficient is regarded as secondary by those opposed to federal remedial legislation--a position supported by this Commission in a 1983 recommendation.

Yet in the Commission's deliberations on the recommendation in this report, many tax administrators informed us that they did not favor an alternative recommendation that would allow states to form compacts to collect sales taxes because it would not be efficient. Such a scheme, they said, would not work in all states and would be more costly to administer.

Have state officials--and the Commission majority who would normally defend state autonomy--transformed their thinking? Is efficiency now the most

important consideration in tax policy? If so, then business has a point it may well make to Congress: If one applies the standards of efficiency sought by tax administrators in interstate mail order sales, then one would think that the most cost efficient means of taxing corporations would be uniform standards enforceable in federal court.

Lack of Consistency. We are in fundamental agreement with one of the philosophical arguments underpinning the Commission's recommendation: that regardless of the merits of sales/use taxes in general, if a state or locality enacts such a tax through the democratic process then citizens of that jurisdiction should not be able to evade it through mail order purchases. Yet, in its own recommendation, the majority ends up violating this principle.

By adopting a $12.5 million *de minimis* rule (only firms with annual sales over that amount would be forced to comply) the majority "solved" the pragmatic problem of prohibitive compliance costs for small firms. Thereby did the majority also acknowledge that its recommendation is philosophically empty. If a citizen--who presumably derives the benefits of the revenues collected by his jurisdiction--should not be able to evade a sales tax by purchasing from a large mail order firm rather than from the local merchant, then neither should he be able to evade the tax by buying from a small mail order firm rather than a large one.

In a subtle but undeniable way, this recommendation would transform the sales tax from one levied on consumers to one also levied on out-of-state vendors--businessmen/citizens who have no vote in that jurisdiction and derive no benefit from its spending. If it is true, as this recommendation implies, that local retail merchants are competitively disadvantaged because out-of-state vendors do not have to collect sales taxes, then the *de minimis* rule would place large mail order firms at a disadvantage to small firms. To remain competitive while still collecting the tax, large firms would have to lower their prices. In effect, they would be paying the tax out of their profits, not collecting it from the citizen/consumer who derives the benefits of his jurisdiction's spending.

Lack of Constitutional Soundness. By design, the *U.S. Constitution* gives states the widest possible latitude in taxing its own citizens, subject only to the restriction on the imposition of tariffs and the requirement that taxes not

burden interstate commerce. Yet this recommendation asks Congress to determine the scope and authority of states with regard to their power to tax nonstate sources of sales tax. If Congress can set standards for the collection of sales taxes in other states, using federal courts to settle disputes, then Congress may, at a later point, set uniform sales tax rates for the states.

Particularly objectionable in this recommendation is the provision for a single-rate tax for those states with local jurisdictions which also impose a sales tax. Mandating this, even for a limited purpose, represents an unprecedented intrusion into state-local fiscal relations. The national government has no authority under the U.S. Constitution to interfere with the taxing authority of localities. That is prescribed by each state, either through legislation or by the state's constitution. If Congress can dictate a single state-local sales tax rate, what is to prevent it from mandating other uniform rates on the ground that such uniformity removes impediments to the free flow of interstate commerce?

In the 1985 case of Garcia v. San Antonio Metropolitan Transit Authority, the Supreme Court held that the Congress of the United States had the right to determine the scope of state authority--in effect ruling that the political process protected the rights of the states, not the Constitution. Most of the members of this Commission, including the majority in this recommendation, are extremely adverse to that decision. Yet, defining the scope of state authority is precisely what this recommendation asks the Congress to do. Those of us opposed to this recommendation believe that federalism is more than mere efficiency and administration. At its core it is about diversity while still maintaining unity. Our Constitution reserves a broad range of powers for states to undertake governmental activities of their own choosing, and at the same time provides mechanisms for states to solve problems jointly.

If states find that problems involved in taxation of out-of-state mail order sales escape solution by individual state action, we suggest that the appropriate remedy, consistent with federalist principles, would be to ask Congress for legislation authorizing state compacts to facilitate the collection of sales taxes. Such a remedy would encourage state problem solving, could facilitate speedy remedies in state courts, and would bypass the dangerous precedents involved in federal legislation which intrudes upon state taxing authority.

It is a Faustian bargain the Commission has struck. The new revenues look attractive today, especially to tax administrators and politicians who will not be around when payment--in the coin of authority--is demanded. To paraphrase

a great American who understood Faustian bargains only too well, "those state and local officials who would give up a little authority to the national government in exchange for a little revenue, deserve neither revenue nor authority."

NOTES

1/ National Bellas Hess v. Illinois Department of Revenue, 386 U.S. 753.

2/ Most states that enacted sales taxes (taxes on purchases) followed them shortly thereafter with a use tax, the main purpose of which was to tax purchases made in other jurisdictions by residents of the state. Typically, the use tax is a tax on "the enjoyment of that which is purchased." When the purchase would, in the absence of jurisdictional problems, be subject to the sales tax. While there is no meaningful economic distinction between sales and use taxes as commonly defined, the courts have held them to be different in terms of the vendor's collection obligation.

3/ In ten states and Washington, DC, a newly purchased motor vehicle is subject to a special levy in lieu of a sales or use tax. This levy is sometimes at the same rate, higher in one state, and lower in a few others.

4/ Breakage results from the fact that the amount of tax which the vendor is required to remit is based on total taxable sales; this amount will be less than the aggregate taxes collected on individual sales.

5/ Due, John F. and John L. Mikesell, "State Sales Tax Structure and Operation in the Last Decade--A Sample Study," National Tax Journal, Vol. XXXIII, March 1980, No. 1, p.42.

6/ U.S. Department of Commerce, Bureau of the Census, 1982 Census of Retail Trade. This Census is done at five-year intervals.

7/ Advertising Age, January 17, 1983, reports 1981 direct marketing sales estimated by the Direct Marketing Association of $125 billion, including $45 billion in mail order catalog sales. At a 9% average growth rate from 1972 to 1982 (Census of Retail Trade), projected 1985 sales would exceed $200 billion. However, this includes a large volume of sales that is already taxed (direct marketing in households, e.g., Avon, Mary Kay, Tupperware, or firms with instate business presence) or not be taxable in any case (sales of industrial consumables, charitable sales). Marketing News, December 9, 1983, reported 1982 mail order sales of $90.3 billion, based on the 1982 edition of The Guide to U.S. Mail Order Sales, of which $41.4 billion was to consumers, with a growth rate of 8%-12%.

8/ Fishman, Arnold, The Guide to U.S. Mail Order Sales, 1983, Deerfield, IL, 1984, Marketing Logistics Inc.

9/ There is some evidence that tax avoidance is a motive for mail order and border state purchases; see, for example, "You Can't Hide in Your Mail-Forbes, July 16, 1984, p.86-87; and "Evading of Sales Tax by New York Stores Under Investigation," New York Times, July 30, 1984, p. A1/A17.

10/ Detailed state-by-state estimates are presented in Chapter 2.

11/ Calculated from Advisory Commission on Intergovernmental Relations, Significant Features of Fiscal Federalism, 1985-86 Edition, M-146, U.S. Government Printing Office, Washington, DC, February 1986.

12/ Reported in private conversation by a representative of Vertex, Inc., a Philadelphia software firm.

13/ U.S. Department of Commerce, Bureau of the Census, 1982 Census of Retail Trade: Establishment and Firm Size, U.S. Government Printing Office, Washington, DC, February 1985.

14/ Advisory Commission on Intergovernmental Relations, Local Revenue Diversification: Income, Sales Taxes and User Charges, A-47, U.S. Government Printing Office, Washington DC, 1974.

15/ ACIR Docket Book, 73rd Meeting, April 22-23, 1981, Washington, DC, Tab B, p. 16.

Chapter 2

ECONOMIC CONSIDERATIONS

Debate over the taxation of interstate mail order sales has brought out three economic concerns; revenue losses, competitive effects, and compliance costs. Each of these important concerns is examined in this chapter.

GROWING DEPENDENCE UPON SALES TAXES

The importance of examining these economic concerns rests, first, upon the growing use of sales taxes by state and local governments, and upon the erosion of this tax base caused by interstate mail order sales.

As Table 2-1 shows, in 1983, 45 states and Washington, DC, levied sales and and use or gross receipts taxes, with rates ranging from 2% to 7.5%. An additional 6,397 local governments--counties, municipalities, and special districts --levied sales and use taxes at rates ranging up to 4.25% in New York City, giving residents of the Big Apple a combined rate of 8.25%.1/

Dependence on the sales tax has continued to expand as rates have risen and more local jurisdictions have adopted the tax. From 1973-4 to 1983, the median state sales tax rate rose from 3.8% to 4.4%. During this period, 29 states raised their sales tax rate while only one lowered the rate. As shown in Table 2-1, total state revenues from general sales, use and gross receipts taxes in 1983 were $53.6 billion. This amount represented 31% of all state tax revenues, and the percentage in individual states ranged from 16% to 59%. On a national basis, this source of state revenue is second only to combined corporate and individual income taxes which yield $62.9 billion.2/ The number of local governments using the tax increased from 4,462 to 6,397 during the same period. A detailed summary of the features of sales and use taxes can be found in Due and Mikesell's Sales Taxation.3/

Sales Versus Use Taxes

Most states that enacted sales taxes (taxes on purchases) followed them shortly thereafter with a use tax, the main purpose of which was to tax purchases made in other jurisdictions by residents of the state. Typically, the

Table 2-1

State	Rate	Local Tax?†	1983 State Sales Tax (revenues in millions)	(percent of state tax revenues)
Alabama	4	yes	$660	28%
Arizona	5*	yes	845	41
Arkansas	4	yes	438	33
California	4.75*	yes	7,767	35
Colorado	3*	yes	623	36
Connecticut	7.5*	no	1,104	43
Washington, DC	6*	yes	272	20
Florida	5*	no	3,334	54
Georgia	3	yes	1,173	33
Hawaii	4	no	601	52
Idaho	4	no	165	27
Illinois	5*	yes	2,394	32
Indiana	5*	no	1,523	48
Iowa	4*	no	571	28
Kansas	3	yes	499	32
Kentucky	5*	no	700	27
Louisiana	4*	yes	847	28
Maine	5*	no	271	35
Maryland	5*	no	865	25
Massachusetts	5*	no	1,052	20
Michigan	4*	no	1,969	28
Minnesota	6*	yes	992	23
Mississippi	6	no	762	49
Missouri	4.125	yes	985	36

NOTE: Alaska, Delaware, Montana, New Hampshire, and Oregon have no state sales tax.
†Only in states where local taxes are used as well as authorized.
*Food is exempt.

use tax is a tax on "the enjoyment of that which is purchased" when the purchase would, in the absence of vendor collection problems, be subject to the sales tax. While there is no meaningful economic distinction between sales and use taxes as commonly defined, the courts have held them to be different in terms of the vendor's collection obligation.4/

Use taxes basically cover goods purchased outside the state and brought into the state for use. Most states allow a credit for sales tax paid in other states, some on a universal basis and others on a reciprocal basis. The number of states offering a credit or refund for sales or use tax paid to another state has increased in the last 15 years, so that the "double taxation"

MAJOR FEATURES OF STATE SALES TAX SYSTEMS

State	Rate	Local Tax?†	1983 State Sales Tax (revenues in millions)	1983 State Sales Tax (percent of state tax revenues)
Nebraska	3.5*	yes	357	37
Nevada	5.75*	yes	368	47
New Jersey	6*	no	1,660	27
New Mexico	3.75	yes	480	41
New York	4*	yes	3,532	22
North Carolina	3	yes	826	21
North Dakota	4*	no	146	28
Ohio	5*	yes	2,005	30
Oklahoma	3	yes	409	16
Pennsylvania	6*	no	2,365	28
Rhode Island	6*	no	212	29
South Carolina	5	no	692	33
South Dakota	4	yes	174	54
Tennessee	5.5	yes	1,177	50
Texas	4.125*	yes	3,320	59
Utah	4.625	yes	391	40
Vermont	4*	no	67	19
Virginia	3	yes	722	20
Washington	6.5*	yes	2,454	59
West Virginia	5*	no	745	51
Wisconsin	5*	no	1,209	28
Wyoming	3	yes	190	26
U.S. Total			$53,639	
U.S. Average				31%

Source: Revenue figures from U.S. Department of Commerce, Bureau of the Census, State Government Finances, 1982-83. Rates/features from ACIR's Significant Features of Fiscal Federalism, 1984 Edition.

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argument against taxation of interstate mail order and direct marketing sales no longer carries much weight.

Acceptability of the Sales Tax

Sales and use taxes are not only a major state and local revenue source, but they also are among the more generally accepted forms of taxation. The sales tax consistently scores as one of the fairest taxes in ACIR's annual survey of public opinion on taxes ranking third out of four in annual polls since 1973.

In 1983, in response to a set of ACIR questions "Suppose your federal,

state, or local government must raise taxes, which way would be a better way to do it?", most respondents at each level of government chose the sales tax. (At the federal level, a sales tax was described as a "new national sales tax on all purchases other than food."5/) The responses are shown in Table 2-2.

Table 2-2

PREFERRED TAX TO BE RAISED
(in percent)

	Sales	Income	Property
Federal	52%	24%	na
State	57	23	na
Local	45	12	19%

Source: U.S. Advisory Commission on Intergovernmental Relations, Changing Public Attitudes on Government and Taxes, 1983, S-12, p. 2.

EROSION OF THE SALES AND USE TAX BASE

A truly universal sales and use tax would have as its base all final purchases of goods and services. In practice, however, the base is considerably narrower, and there is considerable variation in the actual base from state to state. A narrower base requires higher rates to achieve the same revenue, may reduce the acceptability of the tax (depending on what is excluded), and will introduce distortions in spending patterns as buyers shift to nontaxed items or nontaxed suppliers. On the other hand, some exclusions from the base, such as food and medicine, may be justified in order to reduce the regressivity of the tax and/or to encourage the consumption of merit goods (goods which society feels everyone should consume as a matter of right, regardless of ability to pay).

Actions by the states have led to some narrowing of the sales and use tax base in the last decade with widespread adoption of exemptions for food, household utilities, and prescription drugs in response to sharp price increases in these necessities. Eleven states added food exemptions between 1971 and 1981; 13 added exemptions for medicines, and 21 for residential fuel, natural gas, and electricity. As an incentive to economic development, 14 states added exemptions for industrial machinery.6/

Other major factors contributing to narrowing the base are interstate sales either by mail order or by border sellers, and nonreporting, especially of the

use tax.7/ Border sales can potentially be addressed in cooperative agreements between neighboring states, and, in any case, these sales present complex legal problems which are quite different from those presented by mail order and direct marketing sales.

As a result of a 1967 Supreme Court decision in the National Bellas Hess case that exempted out-of-state businesses from the obligation to collect taxes for states where they are not located, tax base erosion and tax revenue loss from mail order and direct marketing sales cannot be controlled now. In both border and mail order sales, there is a use tax liability, but the administrative difficulties of collecting from the large number of individual buyers rather than from a smaller number of sellers means that most of the use tax on interstate sales goes uncollected.

These mail order and direct marketing sales include not only purchases by consumers, but also a substantial amount of sales to businesses. Use tax due on purchases by business firms may be collected from the buying firm in cases where the out-of-state vendor cannot be required to collect if the buyer is a registered seller who reports the use tax on a sales tax return. The use tax liability may also be uncovered in the course of a sales tax audit, but Due and Mikesell find evidence of widespread nonreporting. Failure by business firms to report their use tax obligation for out-of-state purchases is the largest single source of "lost" revenue recovered in sales and use tax audits.8/

A 1984 ACIR survey of state revenue commissioners confirmed that finding. Unreported use taxes (primarily on interstate business purchases) were listed as a major source of recovery through audits, ranging from 4% to 75% of audit-generated revenues, with a mean of 52% and a median of 59%. (These figures are based on responses from 14 states.) An average of 1.4% of total state sales and use tax revenues is recovered as a result of auditors detecting unreported use tax on interstate business purchases.9/

Total receipts from use taxes--which consist mainly of taxes on interstate sales to both consumers and business, with automobile purchases excluded--averaged 6.6% of sales and use tax revenue in the 13 states which provided that information in the ACIR survey. The range was from 0.5% to 14.5%. Thus, the actual and potential revenue from the use portion (primarily interstate) of the sales and use tax appears to be quite substantial.

The ACIR survey instrument and a summary of replies are given in Appendix B.

Evidence of Sales and Use Tax Erosion

Evidence of tax base erosion is extremely difficult to track because of the problems of measuring the base. In 1974, Due made an attempt to examine the gap between retail sales reported to state tax collectors and those reported by the five-year Census of Retail Trade. Sales based on data from state tax collectors for 1967 ranged from 49% of the Census figure in Massachusetts to 171% in New Mexico, with 23 of the 41 sales tax states in excess of 100%. Clearly, taxable sales by wholesalers and differences in collection and definition of data more than offset the combined slippage from exempt buyers, exempt commodities, and interstate sales in most cases.10/

More recent attempts to construct a state-by-state measure of the size of the sales and use tax base by ACIR staff also have been unsuccessful in projecting state sales and use tax revenues on the basis of retail sales, tax rates, and exempt items. This method underpredicts revenues for many states--often by a wide margin. Much of this shortfall is probably accounted for by the exclusion of taxable sales to business, but there are no reliable estimates of taxable business purchases (or even of the fraction of sales and use tax paid by business purchasers) on either a national or a state-by-state basis. Fryman attempted to measure the proportion of the Illinois sales and use tax borne by business in 1969,11/ and ACIR staff made a similar attempt for all states in 1977.12/ The most recent attempt to assess the total state and local tax burdens on business, by Wheaton, deliberately omitted the sales and use tax from those computations because of the difficulties involved.13/

Despite these difficulties in measuring erosion in an absolute sense, it should be possible to measure some relative erosion of the sales tax base--assuming that the sales and use tax base has shrunk (or failed to keep pace with income or total sales) in recent years due to rising mail order sales. That is, adjusting for changes in rates and exclusions, it should be possible to predict changes in tax collections from changes in retail sales.

An attempt to measure relative erosion in the last decade is described in Appendix C. Once again, revenue predictions underestimated increases in sales and use tax collections in about half the states. In 19 states, however, it was found that after correcting for changes in rates and exemptions, sales and use tax revenues relative to retail sales are substantially lower--ranging from 24% in Alabama to 50% in Missouri--than would have been expected on the basis of ex-

perience ten years earlier. Thus, some limited evidence exists for recent base erosion, although it is not possible to assign the base shrinkage to a specific source.

Survey Results

One qualitative source of information on base erosion comes from state revenue officials. Two ACIR surveys in the fall of 1984 addressed, among other issues, the problem of erosion of the sales and use tax base (Appendix B). In the first survey, on mail order sales, state revenue commissioners in 35 of the 46 sales and use tax state states (including Washington, DC) replied. In answer to the question, "Does your state lose a significant amount of sales tax revenue due to the increase in sales made by mail order houses?", 30 said "yes," one state answered "no", and four did not know. Among the "yes" states, one ranked this as the most important source of sales tax revenue loss; two ranked it second (one after border sales; one after underground activity); and one ranked it among the top five. Seven other respondents replied by ranking mail order among sales tax revenue losses as high, very high, major, or one of the most significant.

Of the 20 usable replies to the second questionnaire, which dealt with business use taxes, five ranked revenue losses on interstate sales to business as "extremely significant" or "very significant", four as "significant" or "substantial," and only two as "not significant" or "insignificant." Nine did not reply directly or gave dollar figures only.

Need to Estimate Losses

Although it is certain that the erosion of the use tax stemming from mail order sales is causing losses of revenues to states and localities, the extent of these losses is very uncertain. It is necessary, therefore, to take a measure of the problem by estimating these losses.

TAX REVENUE POTENTIAL: A STATE-BY-STATE ESTIMATE

Tax revenue estimation is at best, an inexact branch of economic forecasting. Since the base of sales and income taxes is closely correlated with the behavior of output, employment and prices, projecting tax revenues suffers from all the handicaps of macroeconomic forecasts. In addition, a change in the tax rate, or in coverage and exemptions, interacts with the base as taxpayers are

Table 2-3

STATE TAX REVENUE POTENTIAL FROM
(in thousands of dollars

State	Allocated by Sears, Ward, and Penney Sales	Allocated by Personal Income	Percent of State Sales Tax Revenue**
Alabama	$ 4,358	$ 18,838	0.6-2.4%
Arizona	16,544	19,990	1.6-2.0
Arkansas	41,612	10,825	7.9-2.1
California	104,576	209,495	1.1-2.3
Colorado	8,903	15,012	1.2-2.0
Connecticut	10,342	34,472	0.8-2.6
Washington, DC	1,443	7,625	0.4-2.3
Florida	39,931	63,247	1.0-1.6
Georgia	35,934	22,896	2.6-1.6
Hawaii	421	6,316	0.1-0.9
Idaho	11,654	4,774	5.9-2.4
Illinois	61,022	89,263	2.1-3.1
Indiana	30,321	36,732	1.7-2.0
Iowa	20,785	16,243	3.0-2.4
Kansas	23,051	11,585	3.9-1.9
Kentucky	52,677	21,346	6.3-2.5
Louisiana	38,685	23,266	3.8-2.3
Maine	13,025	5,542	4.0-1.7
Maryland	23,836	35,408	2.3-3.4
Massachusetts	8,962	34,354	0.7-2.7
Michigan	39,783	42,792	1.7-1.8
Minnesota	33,241	30,173	2.8-2.5
Mississippi	44,715	16,241	4.9-1.8
Missouri	44,060	28,596	3.7-2.4

*Includes local sales and use taxes where the local tax is used by all local jurisdictions of given type, e.g., all counties.
**Percent of projected 1985 state sales and use tax revenue.

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confronted by different sets of after-tax prices and adjust their behavior. All of these caveats apply to the two estimates presented in Table 2-3 of potential 1985 sales and use tax revenues that would result from taxing presently untaxed interstate mail order sales. Of course, the aggregate revenue to be derived from a state sales tax must be developed first state by state and then totalled, since the aggregate is dependent on its distribution among states with different rates, coverage, and exemptions. The two estimates in Table 2-3 are based on two different patterns of the state-by-state distribution of sales, and should be interpreted with considerable caution.

The sales base for both potential tax revenue estimates was derived from

MAIL ORDER AND DIRECT MARKETING SALES, 1985*
and percent)

State	Allocated by Sears, Ward, and Penney Sales	Allocated by Personal Income	Percent of State Sales Tax Revenue**
Nebraska	12,126	6,208	2.8-1.5
Nevada	10,517	6,533	2.4-1.5
New Jersey	16,944	58,095	0.9-2.9
New Mexico	22,527	8,176	3.9-1.4
New York	47,439	122,937	1.1-2.9
North Carolina	62,735	30,378	8.4-4.1
North Dakota	10,307	3,848	5.9-2.2
Ohio	38,183	61,960	1.6-2.6
Oklahoma	27,531	14,240	5.6-2.9
Pennsylvania	50,158	76,613	1.8-2.7
Rhode Island	886	6,053	0.3-2.4
South Carolina	29,709	18,810	3.6-2.3
South Dakota	7,867	3,512	3.8-1.7
Tennessee	72,583	36,864	5.1-2.6
Texas	101,020	97,407	2.5-2.5
Utah	10,045	10,238	2.1-2.2
Vermont	7,983	2,615	10.0-3.3
Virginia	36,842	27,660	4.3-3.2
Washington	61,027	49,132	2.1-1.7
West Virginia	38,161	11,001	4.3-1.2
Wisconsin	29,862	27,326	2.6-2.4
Wyoming	4,862	1,962	2.1-0.9

Total Estimated
U.S. Revenue Loss (in thousands) $1,413,166 to 1,486,539

Source: ACIR Staff computations.

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the Guide to U.S. Mail Order Sales, 1983 by using consumer purchases of products (but not services) and a portion of business purchases, and by projecting them to 1985, based upon the rate of growth from the Census of Retail Trade.14/ Corrections were made for major nontaxed items, for retailers with multistate nexus, and for in-state purchases. The estimates reflect only state sales and use taxes and those local sales taxes which apply statewide.

The first estimate allocates all U.S. mail order and direct marketing sales among the states on the basis of actual combined state-by-state distributions of 1982 sales of the big three mail order firms--Sears, Ward, and Penney.15/ This method picks up a propensity to use mail order more intensively in

rural states, as the table clearly indicates. It also has the advantage of basing distribution of sales among states on taxable sales, because mail order sales from those three firms are taxable. All three firms have a physical presence in virtually every state. Thus, the first distribution suggests the amount of mail order shopping that residents of each state might undertake in the absence of tax incentives.

The use of combined Sears, Penney, and Ward data, however, has drawbacks. To the extent that residents of urban states with high sales tax rates use mail order to avoid sales taxes, the combined figures from Sears, Penney, and Ward would understate the shares of current mail order sales in those states. The proportion of mail order sales in such high tax, urbanized states as Pennsylvania, New Jersey, Washington, and Connecticut as well as in New York City (8.25% combined rate) and Washington, DC (6%), may be higher than is reflected in the first column of Table 2-3. In addition, the industry's own analysis suggests that much recent growth has been through specialty catalogs "upscale" merchandise-like gourmet food or higher priced clothing--aimed at young, prosperous, urban markets, rather than the more traditional rural-suburban/lower-to-middle-income market served by the Big Three. For this reason, an alternative estimate is given in the third column, based on distributing mail order sales among states in proportion to personal income.

The national totals of tax revenue potential arrived at by these two methods of distributing sales differ for two reasons. First, the 46 sales tax jurisdictions account for 93% of the sales of Sears, Ward, and Penney, but include almost 97% of U.S. personal income. Second, the different distribution among states with the personal income criterion reflects a shift of estimated sales into some high income, high tax rate states such as New York and Connecticut. These two different state-by-state distributions of revenue potential, then, offer a range of estimates for each state rather than a single figure.

The estimates take into account only state taxes (although interstate mail order purchases from firms meeting nexus standards are currently subject to both state and local taxes), but they do adjust for applicable exemptions of food, clothing, and magazines--the three most frequent exemptions of items widely purchased by mail. An adjustment is also made for in-state purchases by mail order. Detailed explanations of the procedure by which these estimates were made are given in Appendix C.

Estimated 1985 sales and use tax revenue losses are $1.4 to $1.5 billion

or approximately 2.4% of current state sales and use tax collections.

When sales are allocated on the basis of Sears, Ward, and Penney data, the states where the revenue loss appeared to be a particularly high percentage of revenues include Arkansas, Georgia, Idaho, Iowa, Kansas, Kentucky, Louisiana, Maine, Minnesota, Mississippi, Missouri, Nebraska, Nevada, New Mexico, North Carolina, North Dakota, Oklahoma, South Carolina, South Dakota, Tennessee, Vermont, Virginia, West Virginia, Wisconsin, and Wyoming. This list indicates the rural pattern in taxable mail order sales from the Big Three that we had anticipated. In nine states, the revenue loss estimates are at least in the 2-5% range of estimated 1985 sales and use tax revenues, and are much higher in some cases.

Allocation by personal income, on the other hand, shows large (or larger) tax revenue losses in the more prosperous and populous states and/or those with the highest sales and use tax rates, including California, Connecticut, Florida, Illinois, Michigan, Missouri, New Jersey, New York, Ohio, Pennsylvania, Tennessee, Texas, and Washington. Because personal income and sales tax revenue are related, the pattern of revenue losses in percentage terms is much more evenly distributed when mail order sales are allocated on a basis of personal income.

Still another consideration in the state-by-state distribution of revenue losses, which cannot be quantified in Table 2-3, is the fact that mail order firms may be more likely to have a business presence--a retail outlet, a warehouse, or a catalog or sales office--in larger and more populous states where they already collect taxes on sales. Thus, the concentration of tax revenue losses in smaller or more rural states may be even larger than the first estimate suggests.

Are the Estimates Too Low?

Tax administrators feel that these estimates of lost revenue may be somewhat conservative. That view is supported by the industry claim that sales are much higher than those reported by the Census of Retail Trade. While the figures quoted from The Guide to U.S. Mail Order Sales, 1983, may be more credible than those of the Census, because the latter is limited to retail sellers with mail order as their primary business, even the Guide figures are lower than those quoted in other trade publications cited in Chapter 1.

In addition to the industry's claims to higher sales estimates, there is considerable "casual" evidence of rapid growth in mail order and direct market-

ing sales. Such market factors as the use of new communications technology, and the opportunity to cater to working women and affluent consumers through specialty catalogs and computerized marketing, provide the basis for relative expansion in the mail order component of retail sales.

American Express, for example, has developed a direct marketing program (American Express Merchandise Sales), which is growing at 25%-30% a year and has an annual sales volume of $220 million.16/ At least one innovative computer marketer has placed computer terminal "catalogs" in such high traffic areas as factory cafeterias and reports high volume and rapid expansion.17/ Comp-U-Store offers a direct marketing line through retail stores (which would be subject to vendor-collected taxes) as well as direct home services (which would be subject to buyer-remitted use tax and, therefore, are likely to escape the use tax). This firm has expanded and diversified from its original role as a discount buying service.18/ Both Comp-U-Store and other services now have computer kiosks in supermarkets and other convenient locations to make mail order sales.

The Direct Marketing Association reports a number of factors contributing to recent and potential growth in mail order and direct marketing sales, including credit cards, syndication, a higher percentage of women who work, and the proliferation of specialty catalogs.19/

Still in the early stages of development are services which are linked directly to the customer's home computer, often as part of a package of banking, news, data base, and other services. If this becomes successful, it will give major impetus to direct marketing sales.20/ Direct marketing is of sufficient importance to receive regular and special attention in the trade tabloid Advertising Age. A special section in early 1983 reported on such developing trends as upscale and specialty catalogs, the growth of sales using toll-free "800" telephone numbers, continued growth of conventional direct mail selling, plans for linking direct marketing to cable television, and automatic dialing as a direct marketing telephone sales technique.21/

Thus, while firm sales figures are hard to come by, it appears that this form of retailing is experiencing growth that is at least as rapid and perhaps considerably more rapid than that of more traditional retail outlets. This trend implies that tax revenue losses will climb rapidly as well.

Are the Estimates Too High?

Industry sources argue that the ACIR estimates of revenue loss are too high.

They support a figure closer to $500 million, for the following reasons:

1. Small businesses are likely to be exempt from collecting these taxes for purely administrative reasons.

2. There are additional mail order sales (besides Sears, Ward, and Penney) that are currently taxed because firms meet business presence requirements in more than one state. (A correction has been made in Table 2-3 for in-state sales in the state where the mail-order firm is located. See Appendix C for details.)

3. Recent poor performance in the mail order industry suggests slowed future growth.

4. Taxation may have dynamic effects reducing industry sales and thus the tax revenue potential.

The *De Minimis* Rule 22/

A *de minimis* rule would exempt small businesses from collecting taxes on their out-of-state mail order sales. Most proposals for such a rule establish a gross sales dollar figure, with amounts ranging from sales of $20,000 to sales of $5-10 million. Some proposals would establish a threshold at a state level, others at a national sales level.

Data from the 1982 *Census of Retail Trade* provide some insight into the size distribution of firms in the mail order business, at least those for which mail order is the primary activity. While there may have been some changes in the last three years, the *Census of Retail Trade* (which is issued at five-year intervals) is the only available source of data on the number of firms in an industry by volume of sales. For 1982, the *Census of Retail Trade*, in Table 4, Sales Size of Firms, identified 5,437 firms in SIC (Standard Industrial Classification) code 5961, mail order houses (i.e., firms which identified mail order as their primary industry) which were operating for the entire year. (These data exclude 421 firms which entered or left the industry during the year; their average sales volume was just under $1 million.)

On the basis of Census figures for active firms with mail order sales as their primary industry, the effects of various *de minimis* sales levels on the number and percentage of firms required to collect the tax and the volume of sales subject to the tax for 1982 are shown in Table 2-4.

It is clear from these figures that the mail order industry encompasses many small firms but that most sales come from a few of the larger firms. In addition, 1,670 firms have mail order as a secondary business or sideline to a

Table 2-4

PRIMARY MAIL ORDER FIRMS FALLING UNDER
VARIOUS DE MINIMIS THRESHOLDS AND PERCENT OF SALES COVERED

De Minimis Sales Threshold	Primary Mail Order Firms* Number	Primary Mail Order Firms* Percent	Percent of Sales Covered
$ 250,000	3,022	56.0%	97.9%
500,000	1,722	32.0	93.6
1,000,000	854	15.7	87.9
2,500,000	388	7.1	81.6
5,000,000	221	4.1	76.2
10,000,000	131	2.4	70.2

*Primary business is mail order sales.

main business in another branch of retailing or even in an entirely nonretail classification. While these firms are not included in the revenue estimates, they can be included in de minimis calculations. The effect is to reduce the percent of firms required to collect the tax under various illustrative de minimis thresholds. Their inclusion is show in Table 2-5.

The effects of such a rule on revenues depends on the threshold established. For example, applying the same percentages of sales covered to the 1985 revenue estimates, a national sales threshold of $250,000 would reduce the 1985 total sales and use tax revenue by abount $30 million, or 2%. Obviously, there is a tradeoff to be made between the number of firms exempt (lowering compliance costs for smaller firms) and the revenue to be generated. A $5-million thresh-

Table 2-5

TOTAL MAIL ORDER FIRMS FALLING UNDER
VARIOUS DE MINIMIS THRESHOLDS

De Minimis Sales Threshold	Firms with Mail Orders as Secondary Business Number	Firms with Mail Orders as Secondary Business Percent	Total Mail Order Firms* Number	Total Mail Order Firms* Percent
$ 1,000,000	695	41.6%	1,549	21.9%
2,500,000	325	19.5	713	10.1
5,000,000	181	10.8	512	7.2
10,000,000	139	8.3	270	3.8

*Both primary and secondary mail order businesses.

old, for example, would reduce anticipated tax revenues by $336 to $354 million (23.8%), yielding adjusted revenues of $1.077 to $1.133 billion. Data are not available to illustrate the effects of de minimis thresholds above $10 million.

Taxes Already Being Collected

The second issue raised by the industry, namely that firms other than the Big Three may currently meet business presence requirements in more than one state, can also be taken into account to some extent using Census data on size distribution. While data are not available on all the possible ways in which "nexus" can be established, the existence of "establishments" should be a reasonable proxy. A firm with only one establishment is not likely to meet the nexus test in more than one state. Ninety-seven percent of the firms listed with mail order as their primary industry operate only one establishment. Of the remaining firms, 104 have two establishments, 30 have three or four establishments, 11 have five to nine establishments, and only seven have ten or more establishments. Even under the very generous assumption that every additional establishment is in a different state (e.g., a firm with ten establishments operates in ten states), the taxes currently being paid by these firms and not reflected in the tables would amount to less than $14 million in 1982 use tax revenue, or not quite $18 million in 1985. (Firm/establishment data are not available for firms with a secondary mail order industrial classification.)

Slower Mail Order Growth

The third issue, recent poor performance in the industry, cannot be validated or disproved on the basis of currently available data. To offset year-to-year fluctuations a ten-year average (1972-82) was used to project mail order sales to the current year. While some observers forecast a rosy future for the industry, others anticipate a major shakeout. For this reason revenue projections were restricted to the immediate future.

Dampening Effect of Tax Collection

Finally, what would be the effect of expanded tax collection on the industry's sales and growth? Sales and use tax revenue losses are a product of the volume and distribution of mail order sales, and the tax rate and exemptions. These factors are interdependent. Higher rates may discourage spending, in general, or discourage spending on taxable purchases as opposed to nontaxable

purchases. Thus, the estimates of revenue loss presented above must be regarded with some caution because requiring that the tax be collected will indeed have an effect on sales. Some purchases will be shifted to local suppliers and still pay the tax, while others may be foregone altogether.

A tax has an income and a price effect. The income effect reduces spending in general because there are fewer dollars left after the tax is paid. The maximum income effect of a tax on income or a totally general sales tax is given by the rate, e.g., the income effect of a general sales tax of 4% would not reduce spending by more than 4%. However, since large amounts of spending currently are not taxable, total spending net of taxes should fall by less.

The shift of some buyers from taxable to nontaxable spending is the effect that in-state retailers presently find so objectionable, since they are required to collect a tax which their out-of-state competitors are able to avoid. The mail order industry is correct in stating that if it were required to collect use taxes, some customers would probably shift purchases to in-state retailers. Thus, the amount of added state and local tax revenue attributable to mail order sales would be less than projected above, because some of the tax revenue would be derived from in-state sales gained at the expense of mail order sales.

The Industry's Estimate

Industry representatives presented an alternative estimate at ACIR's June 1985 hearing. That estimate projected only $500 million in additional tax collections, in contrast to ACIR's estimates in the $1.4-$1.5 billion range. Basically, the industry estimate differs from the ACIR work in assuming that the patterns of exemption (magazines, food, and services) of the ten most populous states apply to all states, and that many suppliers already meet the nexus test in most states. The process of determining the proportion of sales excluded under a _de minimis_ rule is also quite different and involves making assumptions about size distributions for which no statistical support is given by the industry. Finally, this alternative estimate provides no projection to 1985 of sales and tax revenues; such a projection would increase the industry's figure for additional tax collections by approximately 20%.

COMPETITIVE EFFECTS

While state revenue officers are primarily and fairly uniformly concerned about revenue losses and base erosion, firms that compete in the retail market-

place are divided in their concerns about price competition and its effect on sales and profitability. Both in-state businesses and out-of-state businesses with sufficient physical presence in a state to create a tax liability feel that their prices would reflect a more neutral tax treatment if other out-of-state mail order competitors were required to collect use taxes. Those out-of-state mail order firms not currently having enough presence to require them to collect the tax feel that they are sufficiently handicapped by distance, that they receive no services from the destination state, and that they, therefore, should not be required to collect use taxes.

The competitive problem is a concern both in border sales and interstate mail order sales, but this study addresses only the latter issue. The price differential between states is not just the difference between one state's sales tax rate and the rate in the other state, but the difference between the tax rate in the buyer's state and zero--no tax. This price difference can range as high as 8.25% (combined state and city sales tax in New York City), putting the local retailer at a competitive disadvantage relative to mail order sellers who have no local business location and therefore no obligation to collect and remit sales or use taxes.

Although it is very difficult to measure the revenue loss resulting from interstate mail order sales beyond the reach of the sales and use tax collection obligation, it is even more difficult to measure the competitive effect--sales made by out-of-state sellers that would have been made by in-state sellers that can be attributed to the tax differential. In addition, the two effects--competitive and tax revenue loss--are interdependent. Customers who switch to an out-of-state supplier for tax reasons create both a loss of sales to in-state firms and a loss of sales tax revenue to the state.

These two problems are particularly serious for jurisdictions with high rates of tax, such as the States of Connecticut (7.5%) and Washington (6.5%) and the City of New York (with a combined state and local tax rate of 8.25%). Increased reliance of state and local governments on sales and use taxes--both rate increases and wider local use--has exacerbated both the state and local tax revenue problem and the competitive problem.

Price Elasticity of Demand

The response of consumers to price differentials is called "price elasticity of demand." This measure of the amount by which purchases are reduced or

shifted in response to a particular price change or price differential is greater when there are close substitutes, or when the price is large relative to one's income. It is also greater over long time periods. Economists estimate price elasticities for various commodities.23/ And, taxes, of course, add to the prices of these commodities.

However, there are two important qualifiers that should be considered in using this traditional economic approach. First, a specific product, e.g., Wrangler boy's jeans, is identical from either an in-state or out-of-state seller, which would make price elasticities of demand in comparing these two suppliers very high. Second, there is a problem of time and/or distance, so that while the product may be a perfect substitute, the seller is not. Direct out-of-state purchases are only convenient for those who live near the border; direct marketing and mail order purchases usually involve some delays and other inconveniences (e.g., examining or trying on the merchandise, service, or installation problems.) While the catalog price quoted may be lower (partly as the result of lack of store overhead, partly in compensation for the inconveniences), freight charges and other transaction costs may eliminate some of the advantage. The more inconvenience, transaction costs, or other problems associated with buying out-of-state, the lower the elasticity of demand (i.e., shift of purchases to the nontaxed out-of-state supplier) will be in response to a state tax hike or other rise in the price differential.

If demand is highly inelastic, more of the tax burden falls on the consumer, but the consumer is also less sensitive to price differentials between competing suppliers, making the issue of uniform tax treatment less critical. Where demand is more elastic, the tax differential is more critical.

Mail order firms argue that they have other disadvantages in both price and nonprice competition with local retailers that more than offset any tax advantage. These include reliance on catalogs rather than displays and salespersons, high shipping costs, and high advertising expense, and other handicaps. Thus, they do not see a tax advantage in price as a significant determinant of the use of mail order suppliers. In fact, some direct marketers minimize the importance of price as a determinant of the decision to buy by direct mail rather than from a retail outlet. In two surveys cited in the Direct Marketing Fact Book, price was fairly low on the list of reasons for purchasing through mail order (cited by only 5% of the customers in one survey and 14% in another).24/

Attempts at Measurement

The problem of measuring the competitive effect of state-to-state price differences, including price differentials created by sales and use taxes, has received relatively little attention. An early (1968) study by Wales examined the effect of liquor price differentials on in-state and out-of-state sales. He estimated that 53% of all liquor tax revenue in New Hampshire and 26% of that in Vermont derived from sale of liquor to out-of-state customers, while six other states derived more than 5% of liquor sales tax revenue from nonresident sales and three states lost significant sales and revenue (Massachusetts 14%, Kentucky 9%, and Maryland 6%).25/

A more recent and more thorough study of the effect of tax differentials on sales was undertaken by Fisher, based on experience in the Washington, DC, metropolitan area. Fisher reviews several earlier studies which suggest that a 1% rise (or, by inference, differential) in a local (metropolitan) sales tax rate will lower sales by about 6%. Fisher took into consideration transportation costs for the buyer, and disaggregated purchases into broad commodity categories. Apparel consumption showed the highest price elasticity. This result is important for mail order sales, since apparel is a much higher percentage of mail order sales (about 24%) than of retail purchases in general (about 10%).26/

Additional insight into the effect of state-to-state price differences on sales comes from a 1985 ACIR study of cigarette bootlegging.27/ In this study, each one cent price differential reduced a state's cigarette sales by almost one-half pack per capita (.469). In New Hampshire, where the tax rate is nine cents lower than in neighboring Massachusetts, cigarette sales per capita are the highest in the nation--80.8% above the national average in fiscal 1983--while Massachusetts' sales were 7% below the national average. While cigarette data should be used with caution, since users frequently use large quantities and can buy "in bulk" at intervals, this study does suggest that consumers are aware of, and responsive to tax-induced price differentials between states.

Since local firms and mail order firms stock similar commodities, their products are close substitutes, differing mainly in convenience of purchase. Over time, a substantial price differential created by sales and use taxes could induce significant shifts to mail order sellers, particularly on big ticket items where the savings from avoiding sales and use taxes is large relative to the cost or inconvenience of shopping in this fashion.

This competitive effect was not adequately reflected in the revenue loss estimates in Table 2-3, because sales were apportioned among states on the basis of the available "destination" data from Sears, Ward, and Penney, all of which were taxable sales.28/ Thus, some sales which now are being shifted to mail order would become taxable in-state sales in the highest tax states. For this reason, tax revenue loss estimates in Table 2-3 are probably most understated for those states--Connecticut, New York (City), Pennsylvania, New Jersey, Washington, Minnesota, and Washington, DC.29/

Justice Fortas, in his dissent in the Supreme Court's National Bellas Hess decision, saw the competitive issue as a critical one:

> While this advantage to out-of-state sellers is tolerable and a necessary Constitutional consequence where the sales are occasional, minor, and sporadic and not the result of a calculated, systematic exploitation of the market, it certainly should not be extended to instances where the out-of-state company is engaged in exploiting the local market on a regular, systematic, large-scale basis. In such cases the difference between the nature of the business conducted by the mail order house and by the local enterprise is not entitled to Constitutional significance ...the volume which, under the present decision, will be placed in a favorable position and exempted from bearing its fair burden of the collection of state taxes certainly will be substantial.30/

In 1980 hearings in Congress on several bills which addressed the jurisdictional limits of the sales and use tax, the testimony of the New York State Board of Taxation on the competitive issue was typical of the views of tax administrators:

> Aside from the loss of revenues involved, such tax free competition places the small business, which this bill purports to protect, at a competitive disadvantage. This bill favors out-of-state mail order and border vendors over small local businesses selling competitive products.31/

COMPLIANCE COSTS

The final economic effect considered in this chapter is the cost of compliance with the sales and use tax laws of multiple jurisdictions. Compliance costs have been the major source of business complaints about extending the reach of the sales and use taxes.

Vendor Collection

Sales and use taxes are with some important exceptions, collected by the seller. This is primarily a matter of administrative convenience; it is much less costly to collect from a relatively small number of vendors than a large number of individual buyers. Major exceptions to vendor collection include:

1) taxable business purchases for which the business buyer remits the tax along with its collections on behalf of its customers' taxable purchases; and

2) interstate sales of motor vehicles, where the tax is collected from the purchaser when the vehicle is registered.32/

Collection Cost Provisions

The fact that the tax is, in most states, considered a tax on the buyer but collected and remitted by the seller poses some problems. In some states, the costs of collection are at least partly defrayed by allowing the vendor/collector to keep a percentage of the tax.33/ In other states, the costs of collection are borne entirely by the seller.

Due and Mikesell identify 19 states which provide no compensation to vendors at all; other states either provide a uniform percentage of the tax as a rebate to cover collection costs (ranging from 1% to 3.6% in 1980), a flat dollar amount, or a discount that diminishes with the amount of tax due.34/ (See Table 2-6 for a summary of collection cost allowances.)

Multistate sellers find compliance problems to be more severe than those faced by single state sellers. One multistate vendor with a substantial secondary business in mail order sales identified exempt items as the most difficult single problem; of the 46 sales tax states (including DC), he indicated that nine had a large number of exemptions and four states in particular created very high compliance costs for that reason. However, the same vendor indicated that his firm and others had worked out a partial resolution of this problem. The firm, together with the auditor of the taxing state, had reviewed the makeup of the firm's line of products by sales volume in those lines where some items were taxable and others were not, and determined an average rate for that line. For example, if the state's tax rate was 4%, and 40% of the firm's clothing line sales were taxable and 60% were not, based on the product mix and past experience, that part of sales would call for an effective tax rate of 1.6% paid to the state. Other approaches also might be developed to simplify compliance.

Table 2-6

Collection Cost Allowance
(percent of collections)

State	Cost Allowance	State	Cost Allowance
Alabama	2%	Missouri	2%
Arizona	none	Nebraska	3%
Arkansas	2%	Nevada	1.5%
California	none	New Jersey	none
Colorado	3.3%	New Mexico	none
Connecticut	none	New York	none
Washington, DC	none	North Carolina	3%
Florida	1%*	North Dakota	none
Georgia	3%	Ohio	1%
Hawaii	none	Oklahoma	3%
Idaho	breakage**	Pennsylvania	1%
Illinois	2%	Rhode Island	1%
Indiana	1%	South Carolina	1%*
Iowa	3%	South Dakota	none
Kansas	none	Tennessee	1.5%*
Kentucky	1.25%	Texas	1%
Louisiana	1.5%	Utah	none
Maine	none	Vermont	none
Maryland	1.2%	Virginia	3%
Massachusetts	none	Washington	none
Michigan	$50	West Virginia	none
Minnesota	none	Wisconsin	2%††
Mississippi	2%†	Wyoming	none

*Sliding scale, larger percentage allowance for smaller sales levels.
**The vendor is required to remit amounts based on total taxable sales; this amount is less than the aggregate taxes collected on individual sales.
†Mississippi limits the allowance to a maximum of $50 per month.
††Wisconsin's rate is on the first $10,000, lower thereafter; other states' rates are for most sales, with higher allowances on first $1,000 or $2,000.

Source: Due, John F., and John L. Mikesell, Sales Taxation: State and Local Structure and Administration, 1983, p. 328.

Interjurisdictional Sales

The primary difficulty in having vendors collect a tax which is the liability of the purchaser arises when sales are made between taxing jurisdictions. If the seller has a business presence in the destination state, that seller is usually liable for collecting and remitting sales or use tax (almost always use tax). Many court decisions on interstate sales and use taxation are based on

situations where there is difficulty in determining the nature of business presence, or nexus, required to create a use tax collection obligation. (See Chapter 3.)

In the absence of adequate nexus, the state of destination cannot require an out-of-state vendor to collect and remit the tax. While purchasers are legally liable for the tax, the cost of collection from all but the largest and most frequent buyers from out of state would far exceed the revenue recovered. Thus, when the jurisdictional reach of the state's usual method of collection is restricted by the nexus requirement, the use tax is far more likely to escape collection. The more demanding the nexus standard is, the larger will be the volume of sales escaping sales or use tax.

Three aspects of the sales and use tax are of particular relevance to the taxation of interstate sales. These are: (1) the general reliance on the destination principle rather than the origin principle, (2) the actual burden of the tax borne by the buyer vs. the seller, and (3) the issue of who benefits from the use of the revenues collected.

Destination Versus Origin Principle. The sales and use tax is usually regarded as due to the state of destination rather than origin, i.e., the relevant rate is that of the destination state and the revenue accrues to that jurisdiction. This generally accepted principle, which is of considerable importance in the tax treatment of interstate sales, reflects a desire to treat sellers equally with respect to the tax burden in the final price of the product, so that consumers do not prefer out-of-state to in-state vendors (or vice versa) on tax grounds alone. Taxation based upon this principle--when complemented by a satisfactory system of rebates and credits for interjurisdictional sales--could achieve competitive neutrality. However, compliance costs for firms and administrative costs for governments would be higher.

The general application of the destination principle also reflects the belief that most, if not all, of the burden of the sales and use tax falls on the consumer, and therefore the consumer's state of residence has the stronger claim to the tax revenue.

Incidence of the Tax Burden. Because of the enormous diversity in state sales and use taxes, it is difficult to generalize about their incidence. Due and Mikesell examined the legal incidence of these taxes in their summary of the

features of sales and use taxes. They classified 17 states as having consumer taxes (legal incidence on the buyer), 13 states as having vendor taxes (legal incidence on the seller), and 15 states and Washington, DC, as having hybrid taxes.35/

Regardless of who is considered legally liable for a tax, the distribution of the economic burden is determined by market forces. When a tax is imposed on a product or service, the product price may rise, or the after-tax price received by the seller may fall, or some combination of the two. To the extent that the price rises as a result of the tax, the consumer bears that part of the tax. To the extent that the after-tax price received by the seller falls as a result of the tax, the seller bears that part of the tax. Thus, economic incidence focuses on who actually bears the tax in the form of higher prices or lower net revenues, rather than who is legally responsible for collecting and remitting the tax.

Depending on the relative elasticities of supply and demand, the incidence or burden of the tax will be shared in varying combinations between the buyer and the seller. However, when the tax is imposed on all sales regardless of source, for a particular seller demand will be less elastic than it would be if the tax was less universal in coverage. In that case, much more of the tax burden will fall on the consumer. Thus, the more universal a sales tax is in its coverage, the more likely it is that the bulk of the burden of the tax will fall on the buyer, not the seller. This economic observation reinforces the appropriateness of applying the destination principle to the sales and use tax.

Benefit to Whom? The sales and use tax is often justified in economic terms primarily on an ability-to-pay principle, with either purchases or sales as the measure of ability to pay taxes. Like any tax, however, it is also evaluated on a general benefit principle, that the tax should be paid primarily by those who benefit from the services offered by the state. The benefit issue was cited as a relevant consideration in the majority opinion of the landmark case, National Bellas Hess, for example. It is argued by mail order sellers that their exclusion from collecting the tax when they have no business presence in the state is justified because they do not receive any substantial benefits from the destination (taxing) state.

Even if the sales and use tax is considered on a benefit basis, the benefits to the buyer would be the primary basis of benefit justification, since

most of the incidence falls on the buyer. Furthermore, some observers argue that, indeed, there are benefits created by the state to the out-of-state seller in that the state has a substantial role in creating, developing, and sustaining the consumer market in which these sales are possible. The burden on the seller consists primarily of collection or compliance costs, an issue addressed below.

Administrative Complexity

Beyond different sales and use tax rates in 45 states and Washington, DC, are other distinctions. Largely, this concerns which items are subject to tax and which purchasers (such as local government agencies and charitable organizations) are tax exempt.

Out-of-state retailers point out that compliance with multiple state regulations is much more costly than the compliance burden on competing in-state sellers, who deal mainly with a single tax agency and a single set of rules. If the out-of-state seller must also collect and remit local sales taxes, as Sears, Ward, and Penney presently do, the number of jurisdictions rises to about 6,700! (This number may overstate the difficulty of compliance with local taxes, because a uniform rate is collected in all or nearly all of a particular kind of local jurisdiction--town, county, parish, or school district--in a number of states.)

Measuring Compliance Costs

Compliance Costs in the Willis Report. The most detailed treatment of the problem of sales tax compliance costs is found in the 1965 Willis Report, which devotes two chapters to the subject.36/ Estimates of compliance costs from a survey of a cross-section of interstate sellers are compared with data from a local retailer study which had been conducted in Ohio.

In general, the study found that compliance costs of interstate sellers were not significantly higher than those of in-state firms. The compliance costs, which are all costs of charging, collecting, recording, and remitting the tax both as buyer and seller ranged from negligible up to 2% of gross receipts for the interstate firms, with a mean of 0.05%.

The study also found, as expected, that the compliance cost was larger relative to gross receipts for small firms, with a median of 0.02%-0.05%, compared to larger firms where it ranged from 0.005% to 0.01%. Higher dollar costs of multi-

state filings fell mainly on those larger firms with lower median costs (economies of scale). The median compliance cost for local retailers in Ohio in the comparison study was substantially larger than that of interstate sellers (0.097% versus 0.018%).

Compliance Costs Since the Willis Report. It should be noted that technological progress in data processing and electronic devices (cash registers, calculators, microcomputers, etc.) have probably reduced compliance costs in the last two decades. At least one firm was able to provide use with detailed information on computer software and other assistance provided commercially by his firm to businesses with multistate sales and use tax obligation. That firm indicated that the cost of staying current with sales and use tax rates and exemptions was relatively low for all but the smallest firms.37/ In addition, a state rebate in the form of either breakage or a percentage allowance (described earlier in this chapter) covers some part of compliance costs in 27 of the sales tax states.

A study by the accounting firm of Peat, Marwick, Mitchell, and Company for the American Retail Federation provides a recent (1982) look at compliance costs. The study measured compliance costs in seven states--Arizona, New York, California, Maryland, Pennsylvania, Illinois, and Missouri.38/ Unlike the earlier Willis Report, this study measured costs as a percentage of sales and use tax collected. It found gross costs ranging from 2.03% of taxes collected in Missouri to 3.75% in Arizona, less credits for collection costs ranging from none to 2%. At the current sales tax rates in those states, these collection cost figures are equivalent to 0.083% to 0.19% of gross receipts, comparable to the results in the Willis Report. Ironically, the highest collection costs were in those states that allowed no credits for collection costs. The study was limited to nonmail order retailers so that it could be focused on the relative compliance cost of a particular state sales and use tax structure. It was also found, as in the Willis Report, that there were significant variations by firm size, with higher compliance costs for smaller firms than for larger ones.

Finally, a study by the same firm for the Small Business Administration in 1984 confirms that there is a significant compliance cost differential between small and large firms (defining small as sales under $1 million, medium as $1-10 million, and large as sales over $10 million).39/ This 1984 study found

that a number of cost elements, including office equipment expense, register collections, drawer balance and reconciliations, bank deposits, filing and remitting returns, and theft insurance exhibited significant economies of scale. Using a "base case" (a 4% tax with no exempt items or users, no local tax, and monthly filing), compliance costs were found to range from 1.023% of taxes collected for large firms to 3.345% for small firms. The cost to small firms could be cut almost in half with less frequent filing (quarterly rather than monthly). Adjusting for exempt users and exempt items yields a compliance cost estimate of 1.256% of taxes collected for large firms, 2.095% for medium firms, and 4.025% for small firms. More than half the additional cost for a representative state rather than for the simple system in the "base case" is accounted for by exempt items. As suggested earlier, at least some states and some retailers have worked out processes for simplifying this problem where the retailer has multiple lines and the state has a complex pattern of exempt items.

The issue of costs of compliance has played an important role in the hearings on proposed legislation. Despite the limited availability of hard data on the magnitude of compliance costs, testimony from mail order firms emphasized their position that the diversity of state and local taxes and the cost of learning the rules--a significant part of total compliance costs--were imposing excessive burdens on mail order firms. From the opposite perspective, the California State Board of Equalization argued that "...those compliance problems are generally no greater than the compliance problems faced by local merchants."40/

During 1973 hearings, two possible solutions to small business compliance costs emerged. Jerome Hellerstein proposed a *de minimis* rule, which was subsequently incorporated in several of the proposed bills 41/; and the "Traigle plan," named for the Louisiana Commissioner of Revenue, provided for a uniform combined state-local rate to reduce the number of jurisdictions from about 6,700 to 46 (45 sales and use tax states and Washington, DC).42/

Since the 1973 hearings, other suggestions have been made for addressing the issue of compliance costs generally. One proposal would limit the extension of use collection obligations to state sales and use taxes only. (This proposal, plus local taxes only where they apply to all cities or counties in a state, was reflected in the sales tax rate assumptions underlying Table 2-3 estimates.) Like the Traigle plan, this method would reduce the number of rates to 46, without the complexities involved in determining the appropriate single combined

state and local rate. Another suggestion is to extend the practice of a collection cost allowance from the present 27 states to all sales and use tax states.

NOTES

1/ Detailed features of state and local sales and use taxes can be found in Advisory Commission on Intergovernmental Relations, Significant Features of Fiscal Federalism, Washington, DC, U.S. Government Printing Office, annual.

2/ Due, John F. and John L. Mikesell, Sales Taxation: State and Local Structure and Administration, Baltimore, Johns Hopkins University Press, 1983.

3/ Ibid.

4/ This legal distinction is discussed in Chapter 3. Use tax has different meanings in different states, although the most commmon use is for tax collected from the purchaser rather than the seller. Some states, e.g., Michigan, apply the term also to all taxes on automobiles, which are due at registration. States also differ in their willingness to credit another state's sales tax against use tax due in the state of residence, although the vast majority now either give a general credit or a reciprocal credit for taxes paid in the state of purchase.

5/ Advisory Commission on Intergovernmental Relations, Changing Public Attitudes on Government and Taxes, 1983, S-12, Washington, DC, U.S. Government Printing Office.

6/ Gold, Stephen, Recent Developments in State Finances, Legislative Finance Paper #32, National Conference of State Legislatures, February 1983.

7/ One method for escaping taxation, reported in private conversation by a manager at a large multiplant firm with operations in a number of states, is to centralize purchasing in a state with broad exemptions of industrial purchases; items purchased can then be shipped to plants in states with more inclusive taxes on business purchases and thus avoid the tax liability.

8/ Due and Mikesell, op. cit., pp. 228-9. See also Due, John, "Evaluation of the Effectiveness of State Sales Tax Administration," National Tax Journal, June 1974, pp. 197-219.

9/ Calculated as a percentage of adjusted 1982 revenues. Revenue figures used are those in Table 2-3.

10/ Due, John, National Tax Journal, op. cit., pp. 197-219.

11/ Fryman, R.F., "Sales Taxation of Producer Goods in Illinois," National Tax Journal, June 1969, pp. 273-81.

12/ ACIR, Regional Growth: Interstate Tax Competition, A-76, Washington, DC, U.S. Government Printing Office, March 1981.

13/ Wheaton, William C., "Interstate Differences in the Level of Business Taxa-

tion," National Tax Journal, March 1983, pp. 83-94.

14/ The figures for mail order and direct marketing sales are projected to 1985 by using the average rate of growth for the preceding ten years. These sales figures are considerably lower than those provided by some industry publications, which range as high as $140 billion.

15/ Data on state-by-state sales supplied by these three firms and merged to protect confidentiality.

16/ "Mail Power Fuels Unit of AmEx," Advertising Age, September 13, 1984, p. 8.

17/ Reported in private conversation.

18/ "Comp-U-Store System Could Change Retail Economics," Direct Marketing, July 1983, pp. 101-6.

19/ Direct Marketing Association, Direct Marketing Fact Book, Washington, DC, 1983, pp. xix-xxiv.

20/ Mayer, Martin, "Coming Fast: Services Through the TV Set," Fortune, November 14, 1983, pp. 50-6.

21/ A special section of Advertising Age, January 17, 1983, pp. M-9 to M-37 discusses a variety of new developments in mail order and direct mail.

22/ The full legal expression from which this phrase derives is "De minimis non curat lex"--The law does not bother with trifles.

23/ Fox, William F. and Charles Campbell, "Stability of Sales Tax Elasticity," National Tax Journal, June 1984, pp. 201-12.

24/ Direct Marketing Association, op. cit., p. 33.

25/ Wales, Terence J., "Distilled Spirits and Interstate Consumption Effects," American Economic Review, September 1968, pp. 853-63.

26/ Fisher, Ronald C., "Local Sales Taxes: Tax Rate Differentials, Sales Loss, and Revenue Estimation," Public Finance Quarterly, Vol. 8, No. 2, April 1980, pp. 171-88.

27/ ACIR, Cigarette Bootlegging: A Second Look, A-100, Washington, DC, U.S. Government Printing Office, 1985.

28/ This apportionment reflects what we would expect to see in the way of "recovered" revenues if all sales were taxable on the destination principle.

29/ Sales in general can be depressed by high tax rates, not only for sales taxes but the combined total of taxes. High sales taxes not only encourage resort to border purchases or mail order/direct marketing purchases, but also encourage shifting to nontaxed goods and services. In addition, the large sums paid in sales taxes make less available for spending in general.

30/ National Bellas Hess v. Illinois Department of Revenue, 386 US 764.

31/ State Taxation of Interstate Commerce, Hearings before the Subcommittee on Taxation and Debt Management of the Committee on Finance, U.S. Senate, 96th Cong., 2nd Sess., June 1980, p. 767. (Hereafter referred to as 1980 Hearings.)

32/ The initial survey of state tax administrators revealed that several states attempt to collect at least a portion of the use tax liability of individual consumers on a voluntary basis with a line on the state income tax form where out-of-state purchases may be reported. One large midwestern state reported collections of $18,000 from this source over a 20-month period.

33/ One method of defraying collection costs is "breakage." Breakage results from the fact that the amount of tax which the vendor is required to remit is based on total taxable sales; this amount will be less than the aggregate taxes collected on individual sales. For example, a 5% sales tax has one cent of tax due at a sale of ten cents or more; to take an extreme instance, ten sales of ten cents each would result in collection of ten cents in tax, but only five cents--5% of $1.00 in total sales--would be due to the taxing jurisdiction.

34/ Due and Mikesell,"State Sales Tax Structure and Operation in the Last Decade--A Sample Study", National Tax Journal, March 1980, pp. 21-42.

35/ Due and Mikesell, National Tax Journal, op. cit., pp. 24-25.

36/ State Taxation of Interstate Commerce, Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary, House of Representatives, 89th Cong., 1st Sess., June 30, 1965 (hereafter referred to as the Willis Report); Volume 3, Chapter 24, "Problems of Compliance and Enforcement," and Chapter 25, "Sales Tax Compliance Costs." This discussion is based primarily on Chapter 25.

37/ Vertex, Inc., a Philadelphia tax service firm, supplied descriptive material on such a state sales and use tax service.

38/ Peat, Marwick, Mitchell and Co., Report to the American Retail Federation on Costs to Retailers of Sales and Use Tax Compliance, 1982 (mimeo).

39/ Peat, Marwick and Mitchell, "A Comparative Analysis of Sales Tax Compliance Costs for Small Businesses," study performed for the Small Business Administration (unpublished), 1985.

40/ 1980 Hearings, op. cit., p. 893.

41/ State Taxation of Interstate Commerce, Hearings before the Subcommitteee on State Taxation of Interstate Commerce of the Committee on Finance, U.S. Senate, 93rd Cong., 1st Sess., September 1973 p.151. (Hereafter referred to as 1973 Hearings.)

42/ A description of the Traigle plan is given in the 1973 Hearings, pp. 142-50.

Chapter 3

JUDICIAL AND LEGISLATIVE BACKGROUND

Efforts to address the interstate commerce aspects of the sales and use tax have a long and involved history in the courts and in Congress. Much of that history deals with the guidelines that determine which vendors can be required by a state to collect and remit use taxes when sending goods into that state.

Most of the Supreme Court cases are based on the Interstate Commerce Clause of the Constitution, reflecting a concern for preservation of an integrated national market. From the earliest cases in the 1930s to National Bellas Hess in 1967, the Court tried to guard against the possibility of double taxation and preserve the American common market that had been so carefully crafted in the Constitution. At the same time, the Court persisted in trying to meet the requirement of the Due Process Clause by ensuring that in each case the out-of-state vendor who was being taxed (or asked to collect a tax from consumers) had "adequate nexus," i.e., a sufficient business presence in the taxing state to meet the Court's interpretation of the requirements of the Due Process Clause.

Congress has frequently been the battle ground for mail order firms and state revenue officers, with the latter stressing tax revenue losses and competitive considerations and the former emphasizing business compliance costs. One observer, writing in 1978, characterized the legislative history as follows:

> Legislation seeking to provide federal standards for the imposition of sales and use taxes on transactions in interstate commerce has been before the Congress almost continually for the last 15 or so years. The bills which have been introduced can be generally categorized as either taxpayers' legislation, principally aimed at reversing the decisions of the Supreme Court in General Trading Co. v. State Tax Commission (322 U.S. 335 (1944)) and Scripto, Inc. v. Carson (362 U.S. 207 (1960)), or as tax collectors' legislation, principally aimed at reversing the decisions of the Supreme Court in Miller Bros. Co. v. State of Maryland...and National Bellas Hess, Inc. v. Illinois Department of Revenue (386 U.S. 753 (1967)).1/

Efforts to bring about Congressional action have been complicated by the linkage between the jurisdictional reach of the state corporate income tax and

the nexus standard for state sales and use tax, and particularly by the thorny issue of unitary taxation.

JUDICIAL HISTORY

Early Decisions: Validity and Reach of the Use Tax

The use tax was developed primarily to deal with purchases made in other states. Since the sales tax was charged on the transaction, it only applied if the transaction took place within the state. The use tax covered a rather large loophole by providing a companion tax to cover purchases made in other states. The validity of the use tax was upheld in 1937 in Henneford v. Silas Mason Co. (300 US 577). Early decisions also upheld a fairly broad reach for the use tax. In Felt and Tarrant Manufacturing Co. v. Gallagher in 1939 (306 US 62), commission agents working out of a company office in the taxing state were held to constitute a nexus sufficient to require collecting and remitting the tax.

The first case specifically addressing use tax on mail order sales was decided in 1941, when the case of Nelson v. Sears, Roebuck (327 US 359) established that sellers with retail outlets in a state were required to remit use tax even on mail order sales delivered by common carrier rather than through the retail outlet. In this case, as well as in each earlier case cited, the basis of the decision was primarily the Interstate Commerce Clause of the Constitution and the protection of a single national market. In none of these cases did the Court find the limited connection between the firm and the taxing state to be an impediment to the state's requirement that the firm collect and remit the use tax.

In a group of decisions in 1944 (McLeod v. J.E. Dilworth Co., 322 US 327; General Trading Co. v. State Tax Commission, 322 US 335; and International Harvester v. Department of Treasury, 322 US 340), the Court distinguished between sales tax (on purchase) and use tax (on "enjoyment of that which is purchased"). In the first two cases, the Court indicated that the standards for collecting sales and use taxes from vendors were different, although in International Harvester the two taxes were treated alike. The first two cases espoused the view that a sales tax could not be collected in most cases from out-of-state vendors, but a use tax might be acceptable in some cases. This legal distinction was observed in most subsequent cases; later decisions revolved around the linkage issue for the use tax.2/

The linkage issue--nexus--is a legal one, not an economic matter. In economics it is the transaction that is taxed. A mail order sale is considered a transaction at delivery, which takes place in the consumer's state of residence, or the destination state. Thus, the economic argument is that there should be a "level playing field," i.e., all transactions in the same state or "market" should be treated alike in order to minimize the distortion of consumer choice.

The process of collecting the sales or use tax through the vendor, however, requires (under several Supreme Court pronouncements about due process) that the taxing state have some link with the vendor firm, even though the collection process is enforced in state and not federal courts. The definition of the threshold degree of linkage, business presence, or nexus has played a central role in decisions since 1944. States may pursue collection from firms selling in their states only within the limits set by such nexus standards.

More Recent Decisions

Five subsequent cases are of particular importance for the determination of a nexus standard. In 1954, in the case of Miller Brothers v. Maryland, sporadic deliveries by company truck to another state were not considered an adequate business presence. In 1960, in Scripto, Inc. v. Carson (362 US 207), the presence of ten independent jobbers in the taxing state (no offices, property, or full-time employees) met the requirement.

In National Bellas Hess v. Illinois Department of Revenue, the landmark 1967 decision (386 US 753), the Court found that a firm that was mailing catalogs and flyers and filling orders by mail, with no other link to the taxing state, did not have adequate nexus to justify Illinois' demand that the firm collect and remit Illinois use tax. This decision overruled the finding of the Illinois Supreme Court. Twelve states at that time specifically identified mail order sales from out-of-state as subject to collection of the use tax. The National Bellas Hess decision, based primarily on interstate commerce concerns, restricted the states' ability to collect that use tax through the vendor. Because of its importance the decision is reproduced in Appendix D.

One more recent case in which the Court held for a broader reach was in its decision to vacate a district court injunction and remand for further action in the matter of Griffin Inc. v. Tully in 1976 (429 US 68). In this case, a furniture seller in Vermont was making sales and deliveries to New York cus-

tomers, but unlike Miller Brothers, the firm advertised through New York media.

Finally, in National Geographic Society v. California Board of Equalization in 1977 (430 US 551), the Court ruled that the existence of two small offices which solicited advertising but provided no assistance in mail order operations was an adequate basis for a use tax liability on mail order sales.

The cumulative effect of these cases was a lack of clear definition of the criteria by which a state could determine whether an out-of-state seller can be required to collect and remit use tax, although it was established that national catalog advertising alone (National Bellas Hess) or sporadic own-truck delivery (Miller Brothers) by themselves did not meet this elusive set of criteria.3/ Thus, National Bellas Hess effectively excludes out-of-state mail order firms from the obligation to collect and remit use taxes if their only link to the taxing state is the mailing of national catalogs. This overturned the statutory provisions of the 12 states that had, prior to National Bellas Hess, considered advertising (including catalogs) a sufficient nexus.4/

THE COURT'S PERCEPTION OF THE ISSUES IN NATIONAL BELLAS HESS

The majority opinion in National Bellas Hess relied on three interconnected arguments to support the finding that the tax collection obligation would violate the spirit and intent of the Interstate Commerce and Due Process Clauses of the Constitution:

1) protection of the national market ("...if the power of Illinois to impose use tax on National were upheld, the resulting impediments upon the free conduct of interstate business would be neither imaginary nor remote. For if Illinois can impose such a burden, so can every other state,...municipality,...school district.... The very purpose of the Commerce Clause was to ensure a national economy free from such unjustifiable local entanglements.");5/

2) insistence on the need for some minimum linkage between the firm and the state, as evidence of benefit provided by the taxing state to the tax remitting firm (the majority opinion saw this linkage and benefit as the justification for taxing under the Due Process Clause);6/ and

3) the high cost of complying with the tax in multiple jurisdictions (invoking the Interstate Commerce Clause).

All of these arguments have strong economic underpinnings (see Chapter 2). Most of those who cite compliance costs as an important concern for multistate sellers stress that they are a significant burden primarily for small sellers, or in connection with multiple local sales taxes. Both the compliance problems

of small firms and the complexity of dealing with multiple jurisdictions are indeed serious concerns. Those multistate sellers (such as Sears, Ward, and Penney) who currently meet the linkage requirement in most or all sales tax states can attest to the latter problem. Every Congressional attempt to address the taxation of interstate sales has tried to provide some mechanism to simplify compliance. These legislative approaches to the compliance cost problem are described later in this chapter.

The benefit issue is also addressed in the previous chapter as an economic issue. In an economic framework, most of the relevant benefits accrue to the purchaser, on whom most (sometimes all) of the direct burden of the tax falls and whose state of residence is attempting to collect the use tax. Difficulties arise when the sales and use tax is linked to benefits which firms derive from states. Since the tax is on a destination principle, the origin state does not collect the tax on sales delivered out-of-state, even if the origin state provides benefits to the firm. Thus, application of the benefit test to the firm rather than the buyer has developed an unbreakable zone of nontaxability for a large proportion of interstate mail order sales.

Does the out-of-state mail order vendor receive any benefits from the destination state to justify incurring the costs of collection? Observers disagree. Industry representatives argue that any benefits of state services they enjoy are from states in which they own establishments--i.e., the current nexus test is indeed firmly and correctly benefit-based. On the other hand, benefits from the destination state were identified by Justice Fortas in his dissent in National Bellas Hess as "exploitation of the consumer market" in that state. Fortas observed that the firm could not carry out business in Illinois without utilizing Illinois banking and credit facilities and adds "Bellas Hess enjoys the benefits of, and profits from the facilities nurtured by the State of Illinois as fully as if it were a retail store or maintained salesmen therein."7/

Fortas, Black, and Douglas dissented in National Bellas Hess, citing the Commerce Clause, arguing that "exploitation of the consumer market" in itself constituted adequate nexus, a broad definition which would cover virtually all interstate sales. They also pointed to the adverse competitive consequences for in-state competitors of the failure to collect taxes on mail order sales.

LEGISLATIVE HISTORY

The judicial history of state taxation of interstate mail order sales is

paralleled by a series of unsuccessful Congressional efforts to provide definition and guidance on the nexus standards for the sales and use tax. Between 1962 and 1980, four sets of Congressional hearings were held. The legal uncertainties implicit in the Supreme Court decisions led to periodic proposals for federal legislation, some merely to clarify linkage and others to broaden it.

The possibility that Congress might try to define nexus standards for the sales and use tax in a fashion that would narrow the tax base was one of the first concerns addressed by the National Association of Tax Administrators when it was organized in 1934. One of their most immediate objectives was federal legislation authorizing the imposition of sales or use taxes on shipments into a state.8/ However, although several bills were introduced in the 1930s, no action was taken, and the earliest Supreme Court decisions appeared to resolve any Constitutional reservations about the validity of a use tax.

PL 86-272

Legislation enacted in 1959 has played an important role in the legislative history of interstate sales and use taxes even though it deals only with the jurisdictional standards for state corporate income taxes. Several related Supreme Court decisions about the jurisdictional reach of state corporate income taxes in June 1959, led to hasty enactment that year of supposedly interim legislation, PL 86-272, which established conditions under which a state could impose a corporate income tax on a firm not incorporated in that state. These conditions were more restrictive than those approved by the Court. Specifically, a state could not levy a tax on the net income of such a business firm if its only activity within a state was

1) the solicitation of orders for tangible personal property, to be approved and filled from outside the state, or
2) the solicitation of orders from a client or customer if the orders were to be approved and filled from outside the state.9/

Congress also called in 1959 for a study of income taxes on business in interstate commerce, which was later extended to include all matters pertaining to taxation of interstate commerce by the states. As a result, the nexus standards for sales and use taxes became linked to the jurisdictional standards for corporate income taxes for the next 25 years, although the issues are not only separable but in fact conceptually different in important respects--particularly the legal liability for, and economic incidence of the two taxes.

The Willis Committee

The Special Subcommittee of the House Judiciary Committee on State Taxation of Interstate Commerce, known as the Willis Committee, reported in mid-1965.9/ In the hearings, the issues identified were widespread noncompliance, over and under-taxation, and the diversity and complexity of state and local rates, coverage, and administrative procedures. The recommendations were embodied in HR 11798, introduced in 1965, and in several successor bills which were modifications of HR 11798 and which were each in turn known as the Willis bill.

The principal provisions of the original Willis bill were as follows:

1. Sales were to be taxable only by the state in which the buyer received physical delivery. (This embodies the destination principle, except for some border sales, and generally reflected current practice for most sales.)

2. Use taxes were legal, but only if there was a provision for a credit for prior taxes, so that the state of residence of the purchaser would be authorized to collect only the difference between its tax and that of the state of origin on previously taxed sales.

3. All taxes were to be collected by the seller. A state could require an out-of-state firm to collect and remit use taxes only if the vendor owned or leased realty in that state, had an employee whose services were performed entirely in the state, or regularly used its own vehicles or a private parcel service to make deliveries to private residences in the state.

4. Prepaid mail order sales were specifically exempt. The jurisdictional standards for sales and use taxes were the same as those established in PL 86-272 for corporate income taxes, except for the addition of regular household deliveries.

5. Gross receipts taxes were collectible only in the state of origin.

6. The IRS was given a role in the audit of out-of-state sellers on a reimbursement basis. This provision was particularly controversial, and was dropped in later versions.

The Willis bill was opposed by the National Association of Tax Administrators and the Council of State Governments, which contended that it would restrict states' rights and cost the states revenue. The bill was supported in the hearings by the National Association of Manufacturers, the U.S. Chamber of Commerce, and other business groups.10/

In response to criticisms, the role of the IRS in audit was dropped in the 1966 and 1967 versions of the bill; even with this modification neither bill

was enacted. The 1967 National Bellas Hess decision led to the introduction of additional bills, but Congress took no further action and held no further hearings during the remainder of the decade.

The Mathias Bill and the 1973 Hearings

In 1973, a bill introduced by Senator Mathias (MD) and several similar bills were the subject of another set of hearings. The Mathias bill (S 1245) applied to both corporate income and sales and use taxes, applying a uniform jurisdictional standard to both. Because revisions of the Mathias bill were reintroduced in every subsequent Congress and were the subject of three sets of hearings, its provisions are worth considering in detail. The business location standards set forth in that bill are as follows:

> No state or political subdivision thereof shall have the power--
>
> 1) to impose a net income tax or capital stock tax on a corporation other than an excluded corporation unless the corporation has a business location in the state or political subdivision during the taxable year;
> 2) to impose a gross receipts tax with respect to a sale of tangible personal property unless the seller has a business location in the state or political subdivision;
> 3) to require a person to collect and remit a sales tax with respect to an interstate sale of tangible personal property unless the person--
>
>   A) has a business location in the state or political subdivision;
>   B) regularly makes household deliveries in the state or political subdivision other than by common carrier or United States Postal Service; or
>   C) regularly engages in the state or political subdivision in solicitation of orders for the sale of tangible personal property by means of salesmen, solicitors, or representatives (unless such solicitation of orders is carried on solely by direct mail or advertising by means of printed periodicals, radio, or television).
>
> 4) to require a seller without a business location in the state to collect or pay a sales or use tax when such seller has obtained in writing the buyer's registration number in accordance with Section 304.11/

Section 304 provides that

> A person with a business location in a state and purchasing goods in interstate commerce must obtain a registration number from that state. Persons without a business location in the state may rely upon such registration, as evidenced by receiving the registration number from the buyer, in writing, as conclusive authority for not charging and collecting a sales or use tax.12/

The terms in which business location are defined in the Mathias bill are quite similar to those of the Willis bill. Like the Willis bill, mail order and direct marketing interstate sales are specifically excluded. The primary difference is a registration procedure whereby much of the responsibility for collection of the tax on interstate business-to-business sales is shifted from the seller to the buyer. This provision raised strong objections from state revenue officials, who saw it as raising collection costs and reducing the revenue raised. It is much more difficult and costly for revenue officers to track down purchasers than to deal with a much smaller number of sellers.

At least one witness strongly suggested that compliance costs could be best addressed with a quantitative rather than a qualitative rule, i.e., to require collecting and remitting tax on all sales with an in-state destination with an exemption for sellers below some minimum dollar figure.13/

To address the problem of border sales, the Mathias bill allowed for reciprocal collection agreements among contiguous states as an exception to the business location test. The problem of local sales taxes was addressed in two ways. Where there were nonuniform local sales taxes, the business location/delivery tests applied at the local level. Uniform and universal local taxes, however, would be treated as a part of the state tax for purposes of interstate sales.

The Mathias bill, which was introduced regularly in subsequent years, codified the Scripto, National Geographic, and National Bellas Hess decisions, excluding mail order and direct marketing sales from taxation in the destination state. The delivery issue raised in Miller Brothers was addressed in the regular household deliveries provision.

This bill, like the Willis bill, enjoyed strong support from much of the business community, but was opposed by state tax administrators and others who complained that it was unfair to in-state businessmen and would generate tax revenue losses. The registration provision came under particularly heavy fire.

Two other bills were also considered in these hearings. S 282 introduced by Senators Cranston (CA) and Tunney (CA) dealt with sales and use taxes only.14/ Jurisdictional standards were similar to those in the Mathias bill, including the reciprocal agreements provision for contiguous states and the treatment of local taxes, but the registration requirement was deleted. S 2092 introduced by Senator Magnuson (WA) sought Congressional authorization for the already existing Multistate Tax Compact.15/ At that time, the Multistate Tax Commission was primarily concerned about reaching some accord on state taxation of corporate income, so the sales and use tax provisions of the Magnuson bill differed little from the other bills under consideration, except that the controversial registration requirement of the Mathias bill was not included.

The Mondale Bill

Lengthy hearings in 1973, chaired by Senator Mondale (MN), saw much repetition of earlier testimony about complexity and compliance costs, competition and tax revenue losses that received extensive attention in the Willis committee. At the conclusion of the hearings, Senator Mondale drafted still another bill (reproduced in Appendix E) which also dealt only with the interstate sales and use tax issue and attempted to address the issues raised at the hearings.

The definition of linkage was broader in this bill. The complex set of tests for business presence quoted above had, among other effects, excluded interstate mail order and direct marketing sales from the obligation to collect and remit the tax unless there was some in-state business presence. Those rules were replaced in Mondale's bill by a *de minimis* provision, exempting only sellers whose aggregate sales during a calendar year in a particular state were $10,000 or less. This provision took care of the problems of small sellers while allowing states to tax interstate direct marketing and mail order sales without any "nexus" test.

While the Mondale bill included the registration procedure from the Mathias bill, it deleted the list of exceptions provided in other bills for no business location, mail/advertising solicitations, and other qualitative standards.

Detailed provisions on a uniform combined state and local tax rate in the Mondale bill incorporated the basis elements of the Traigle plan. This plan, developed by the Louisiana Commissioner of Revenue, addressed the problem of nonuniform and/or nonuniversal local taxes within a state by defining and registering a single uniform combined rate for each state to apply to

interstate sales. It is described in some detail in the 1973 Hearings.16/

None of the 1973 bills were enacted. At least some interests suggested that legislation was not needed, particularly since some problems of duplicate taxation which had been raised earlier had been resolved.17/ While the Mondale bill resolved many of the objections to the Mathias bill raised by state revenue officers, it was less acceptable to many business interests.

The 1977-78 and 1980 Hearings

Hearings were held again in 1977-78 and 1980. In 1977-78, a slightly modified version of the Mathias bill (S 2173) was the main subject of the hearings. Since mail order sales were still specifically excluded, and the registration provision was still included, state revenue officers were no more enthusiastic about the modified bill than they had been about any of its precursors. They were particularly critical of the registration proposal, which shifted the responsibility for payment for sales to business from out-of-state seller to in-state buyer. Tax administrators argued that enactment of such a provision would lead to a large increase in the number of registered buyers, especially in service industries, who might not find it necessary to register as seller under existing statutes. This large number of registered buyers would place a strain on state audit resources and increase total compliance and administrative costs.

Other points of dispute raised in the hearings included the narrow definition of business presence and the protection of interstate businesses, many of which are large, at the expense of local in-state firms, many of which are small and yet also incur compliance costs. The bill's definition of business presence was supported by the Committee on State Taxation (COST) of the Council of State Chambers of Commerce.

Hearings were held again in 1980 on the next version of the Mathias bill, S 983, which incorporated two provisions responding to the 1970s debate over the relative handicaps of large versus small businesses in interstate commerce. This bill contained a $20,000 *de minimis* rule and allowed the use of the registration provision as an exemption from liability to collect and remit taxes on interstate sales only for firms with sales of less than $100,000 per year.

Eugene Corrigan, executive director of the Multistate Tax Commission, argued that, in this bill, small businesses were being used as an excuse to create benefits for large firms.18/ Other state representatives suggested that relief for small business should be provided in a context of expanded jurisdiction--the

reasoning behind the Mondale bill introduced in 1973 but never given serious consideration. (Much of the testimony at that hearing is summarized in Chapter 4 which identifies the positions of the various constituencies.)

The registration provision, even in modified form, still drew criticism. Opponents of the registration option estimated that current compliance on payment of use tax on business purchases might be as low as 10%, a problem which could only be exacerbated by the registration provision. Proponents pointed out that business purchases, unlike those of consumers, are taxable or not, depending in many cases on the use to which the purchased item is put--information which only the buyer can really determine.

SUMMARY

While issues involving the use tax on interstate sales have been before the courts since the 1930s, the critical decision for mail order sales was National Bellas Hess. That decision, resting like most of the earlier decisions primarily on the Interstate Commerce Clause, restricted the ability of states to require firms to collect and remit taxes on mail order sales if the out-of-state seller did not meet a "nexus" test, variously defined in a series of court decisions, including Miller Brothers and Scripto.

During the period that the Court was narrowing the reach of the customary collection method of the use tax, Congress began grappling with the consequences of some 1959 decisions on the jurisdictional reach of the state corporate income tax, beginning with the enactment of PL 86-272 in 1959 which established the minimum jurisdictional standards for state corporate income tax. A series of hearings, from the Willis Committee (1962-65) through the 1970s considered both sales and use tax and corporate income tax under the broad umbrella of taxation of interstate commerce. The inability of tax administrators and business interests to come to an agreement, and the unfortunate linkage of the two issues--sales and use tax and income taxation of multijurisdictional corporations--has resulted in 25 years of Congressional inaction. During the same time the Supreme Court has further narrowed the reach of the sales and use tax.

NOTES

1/ Cordi, Stephen M., "Sales and Use Taxation of Interstate Transactions," Revenue Administration--1978, National Association of Tax Administrators, p. 207.

2/ Note, "State Use Taxes After National Geographic Society v. California Board of Equalization," Virginia Law Review, Vol. 64, 1978, p. 144-67, provides an excellent summary and interpretation of the relevant cases.

3/ Ibid., p. 157.

4/ State Taxation of Interstate Commerce, Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary, House of Representatives, 89th Cong., 1st Sess., June 30, 1965 (hereinafter referred to as Willis Report) p. 631.

5/ National Bellas Hess v. Illinois Department of Revenue, 386 U.S. 759.

6/ Ibid., pp. 754-60.

7/ Ibid., p. 762.

8/ Willis Report, pp. 213-14.

9/ Ibid.

10/ Congressional Quarterly Almanac, 1965, p. 843.

11/ S. 1245, Sec. 101, as reprinted in State Taxation of Interstate Commerce, Hearings before the Subcommittee on State Taxation of Interestate Commerce of the Committee on Finance, U.S. Senate, 93rd Cong., 1st Sess., September 1973 (hereafter referred to as 1973 Hearings), p. 6.

12/ Ibid., p. 19.

13/ "Statement of Jerome R. Hellerstein, ibid., pp. 150-53.

14/ Ibid., pp. 5a-51.

15/ Ibid., pp. 36-65.

16/ Ibid., pp. 142-50.

17/ Ibid., pp. 120-22.

18/ State Taxation of Interstate Commerce, Hearings before the Subcommittee on Taxation and Debt Management Generally of the Committee on Finance, U.S. Senate, 96th Cong., 2nd Sess., June 1980, p. 373.

Chapter 4

INTERESTED PARTIES AND THEIR VIEWS

State tax administrators and mail order business interests are the two principal vocal parties to the prolonged struggle over whether and how to redefine the nexus standards for collection of the state and local sales and use tax. These are not the only interested parties. Consumers and competing in-state businesses tend to be underrepresented in testimony and the press. Both multistate businesses and some groups of consumers may be numbered among those with an interest in promoting unfettered trade within a U.S. "common market."

As is true of most issues, those most intensely affected by any proposal for change make their voices heard, while others who may be more numerous but who are each individually less affected are less likely to add their view to the discussion. In addition, while the state tax administrators and the mail order businesses each speak with a single voice on their respective sides of the issue, nonmail order businesses and consumers are more fragmented. In particular, groups of consumers who are heavy users of mail order, such as the elderly, may have strong opposition to expanding the tax collection obligation. On the other hand, as a general consumer issue, broadening the base by including interstate mail order sales may represent a tradeoff for a less desirable alternative, such as a higher rate, or fewer exemptions for such items as food, utilities, and prescription drugs, or the more remote but nevertheless viable alternatives of increases in other kinds of taxes or reduced state and local services.

Most of the positions identified here are based on testimony given in the 1980 Congressional hearings which covered both corporate income and sales and use taxes in two proposed bills, S 983 and S 1688, both introduced by Senator Mathias. S 1688 dealt only with corporate income taxes; S 983, which addressed both corporate income and sales and use tax, was discussed in the preceding section and is reproduced in Appendix E. That bill had undergone some modifications since the original version was introduced in 1973, but still did not reverse the exclusion of out-of-state mail order sellers from the tax collection obligation, a situation created by the National Bellas Hess decision. This bill, the last on which any hearings have been held, provides a useful focal point for

identifying major constituencies and their positions. Where possible, recent changes or updates in those positions since the 1980 hearings have been included in our discussion.

The state camp includes the National Association of Tax Administrators (NATA), the Multistate Tax Commission (MTC), the National Conference of State Legislatures (NCSL), and individual state revenue officers, particularly in New York, California, and Washington. Business interests are represented by the Committee on State Taxation (COST) of the Council of State Chambers of Commerce and the U.S. Chamber of Commerce, the Direct Mail Marketing Association (DMMA), the National Retail Merchants' Association, the National Association of Wholesalers Distributors, the National Association of Manufacturers, and other associations, as well as by representatives of individual firms who have spoken or written about the issue.

The position of revenue officers and organizations representing states is that, under current Court-imposed restrictions, tax revenue losses are too high and the competitive position of in-state firms is in jeopardy. Business positions stress compliance costs and the argument (made in the National Bellas Hess decision) that the destination state is justified in asking the out-of-state firm to collect the tax only when the firm is receiving some benefits from the destination state. Adequate nexus, or in-state business location, is presumptive evidence of such benefits; thus, by inference, lack of such linkage to the state is a basis for exemption from collecting and remitting the tax.

Other specific issues raised by one or both sides include extending the collection requirement to border sales in contiguous states; the nexus requirements for local taxes; the use of a uniform state and local rate; the degree of progress toward uniformity among state sales and use taxes; and the desirability and appropriate threshold level of a de minimis rule.

BUSINESS POSITIONS

S 983, the most recent version of the Mathias bill dealing specifically with sales and use taxes, was described in the 1980 hearings as a business-sponsored bill.1/ Certainly the strong support of the business community for S 983 in the hearings would lend credence to that view. That bill codified the Supreme Court decisions relating to nexus for sales and use taxes and provided a certification procedure designed to simplify compliance problems for small firms. The certification provision of S 983 exempted firms with less than $20,000 in sales in a

state from the obligation to collect that state's sales and use taxes. Furthermore, firms with less than $100,000 in sales in a state could collect and remit a combined state and local sales or use tax at a rate certified by the purchaser instead of determining the applicable state and local rate.

Council of State Chambers of Commerce and U.S. Chamber of Commerce

COST (Committee on State Taxation, Council of State Chambers of Commerce), supported the uniform standards for establishing nexus and the uniformity in defining terms for sales and use taxes. Charles Wheeler, representing the U.S. Chamber, argued that the Mathias bill provided much needed relief for small business and would overcome the difficulties created by vague and varied state rules.2/

National Association of Manufacturers

The National Association of Manufacturers, represented by Thomas McHugh, described the present system as unworkable and supported the bill in general and the certification procedure in particular.3/

National Association of Wholesalers/Distributors

S 983 was also supported by the National Association of Wholesalers/Distributors, represented by William McCamant.4/ He cited data from the 1972 Census of Wholesale Trade to support his contention that the typical wholesale firm was small in both sales volume and employment and therefore needed some relief in the difficult compliance task, relief that would be supplied by this bill.

Two specific cases of disproportionate compliance costs were cited, one involving a large number of small sales of seeds by Park Seed Company of Greenwood, SC, and the other concerning compliance with local sales taxes by Alden's, a mail order firm. McCamant indicated that current compliance may be as low as 10%, which he attributed to uncertainty and complexity. He also argued that the bill properly used a clear business location test for requiring a firm to collect and remit the sales and use tax.

Direct Mail Marketing Association

The Direct Mail Marketing Association, which represents a large number of mail order firms, generally supported the nexus standards of S 983, which spe-

cifically excluded mail order and direct marketing firms without an in-state business presence (strictly defined in physical terms in the bill). In arguing for the exclusion of the majority of mail order firms, DMMA stressed the high compliance costs for multiple jurisdictions with different filing requirements and coverage, as well as the need to demonstrate benefits to the firm as the basis for requiring them to collect taxes. The association argued that

> ...the cost and accuracy burden upon the interstate direct mail marketer is wholly disproportionate to (that of) the local retailer as are the benefits, if any, or lack of same received.... Neither our customers nor our firms impose any burden or costs on foreign states in which we sell by mail. We also receive no benefit from the services of the foreign state.5/

Other Business Views

Other businesses testifying in support of the sales and use tax provisions of the bill included the National Retail Merchants Association, representing 33,000 retail firms; two textile associations; and several individual firms with a substantial proportion of their sales in interstate commerce.

Much of the attention in business testimony at this particular set of hearings was focused on the issue of unitary taxation of corporate income. While the sales and use tax issue was the focus of the Willis hearings in the 1960s, in more recent years--particularly at the 1980 hearings--this issue has played second fiddle to the corporate income tax issue. Nevertheless, the positions taken on the sales and use tax provisions and the interests represented did not differ substantially from those of the 1977 and 1973 hearings, although some modifications had been made to the bill in an attempt to meet objections raised by both business firms and tax administrators. Specifically, the controversial registration provision (described in Chapter 3) which had been includied in earlier versions of the Mathias bill had been deleted. The registration provision was replaced in the 1980 version of the Mathias bill with the certification procedures described above, including a $20,000 *de minimis* rule.6/ However, the essence of the bill's nexus standards remained unchanged.

STATE OFFICIALS' VIEWS

Two organizations represented the views of state tax administrators and other state and local officials at the hearings. One was the National Association of Tax Administrators (NATA); the other was the Multistate Tax Commission.

The former represents all 50 states and Washington, DC, while the latter was speaking for 19 member states and 12 associate member states.

National Association of Tax Administrators

NATA's president, Arthur Roemer, testified in opposition to the sales and use tax provisions of the Mathias bill on the grounds that:

1) it would limit state authority and reduce state revenues;
2) it would fail to correct existing federal limitations on state sales and use taxes which had adverse competitive and revenue effects; and
3) it would fail to take account of substantial progress which had been made toward uniformity in state sales and use taxes.7/

The prepared NATA testimony reviewed in detail the areas in which states had made progress toward uniformity in sales and use taxes since they had come under heavy criticism in the 1965 Willis Report. These areas of progress included more widespread provision for credit for sales and use tax paid in other states, more frequent state collection of local sales tax, and greater uniformity in state exemption and resale certificates.

Citing revenue needs and competitive fairness, the NATA statement argued that

> S 983...would limit state taxation without recognition of the uniformity in tax law achieved by the states, the judicial protection provided multistate and multinational taxpayers under existing federal and state law, and without consideration of the need to expand state taxing jurisdiction in certain sales and income tax areas in order to protect local business against discrimination and state and local governments against the loss of much needed revenue.8/

Roemer also argued that any legislation should directly address (and, in fact, overturn) National Bellas Hess, because of the unfair competitive advantage which that ruling created for out-of-state mail order firms.

NATA had adopted a "Policy Statement on the Taxation of Interstate Business" at its 1979 annual meeting, prior to these hearings, which addressed both corporate income and sales and use taxes. The position on sales and use taxes read in part

> If Congress desires to address this area, it should be directed to:

1) codification of existing jurisdictional standards reflected in court decisions such as General Trading and Scripto; and
2) providing power to the states to tax out-of-state vendors which otherwise escape state and local sales and use taxes, thus protecting small local businesses from tax free competition. If it is found necessary to provide for geographic accounting, then it should be on the basis of one rate per state, applicable to out-of-state vendors not included in the jurisdiction of (1), above.9/

At that time, NATA did not wish to separate sales and use tax from state corporate income tax issues. Point (2) is an endorsement for the Traigle plan in some form as a way of addressing business concerns about the compliance costs of dealing with multiple jurisdictions.

Multistate Tax Commission

The Multistate Tax Commission (MTC), which had been formed with one of its major specific goals of preventing the enactment of restrictive legislation, also testified in opposition to S 983. The MTC argued that states had made considerable progress in promoting uniformity in providing credits and refunds for prior payment of both income and sales and use tax on interstate sales, thus defusing an issue which received so much attention during the Willis subcommittee hearings in the early 1960s. The MTC was particularly critical of the nexus standards of the proposed bill:

> All of these jurisdictional restrictions would undermine the ability of the states and their political subdivisions to enforce their sales and use tax laws.10/

While the MTC criticized proposed certification thresholds of $20,000 and $100,000 in sales as too high, the MTC indicated that it did not object in principle to a de minimis concept if such a concept were developed in conjunction with reasonable nexus standards.11/

In 1984 the MTC, in the light of recent developments in unitary corporate income taxation, modified its position to take an even stronger stand on taxation of interstate sales. The MTC withdrew its proposed sales and use tax nexus standards, which excluded orders solicited solely by advertising or direct mail, in order to create a more favorable environment for possible state and U.S. Supreme Court decisions.12/ The withdrawal also paved the way for states to

pursue a standard based on a lower de minimis threshold. Instead, the MTC called on Congress to enact legislation which would authorize states to require a seller to collect and remit use tax if it met any of the following tests:

1) has a place of business within a state;
2) makes regular deliveries into the state; and
3) solicits business from customers within the state in any manner whatsoever, including advertising via mail, radio, television, computers, and other electronic means.13/

A novel part of the proposal called on Congress to authorize states to impose the sales tax on any sales (taxable under its sales and use tax statute) shipped from within its borders to states not imposing such a collection liability on the vendor.14/ This proposal is essentially a "backup," which incorporates a mixed origin-destination principle. Destination is still the primary principle, but origin taxation as a backup would ensure that taxes could be collected on all sales, either in the destination or origin state.

While the intent of the new proposal was to ensure that the tax would be collected somewhere, thus safeguarding both revenues and competitive fairness, it also addressed the benefit issue raised by a number or business groups (for example, the testimony quoted in this section from the Direct Mail Marketing Association). These business representatives argue that the out-of-state vendor with no in-state business location has no tax collection liability to the destination state since the vendor receives no benefit from that state. Under the MTC proposal, tax would be paid either to the state of the purchaser (who presumably does benefit and also bears a substantial share of the burden of the tax) or to the state of the seller, who presumably derives benefits from that state if not from the state of destination.15/

INDIVIDUAL STATES' VIEWS

Three individual state tax agencies testified in oppostion to the sales and use tax nexus provisions. The New York State Department of Taxation was particularly concerned about the competitive issue and about the treatment of local sales and use taxes. Their position echoed that of the MTC as well as other states who testified in this and earlier hearings:

> The problems of tax-free competition across state borders, safeguarding local revenues, and relief to the small business from such unfair competition and the burden of multiple reporting requirements, might be resolved if considered in the context of expanded sales and use tax juris-

diction, rather than as a limitation on such jurisdiction as in this bill.16/

Specifically, the New York State Department of Taxation called for Congressional action to overrule National Bellas Hess and also recommended that border state vendors who regularly solicit sales by radio, television, or printed advertising in a state be required to collect sales or use tax. In exchange, the department expressed its willingness to limit the expansion of jurisdiction to mail order and delivery to contiguous states only, and at a threshold higher than $20,000 in sales.17/

The California State Board of Equalization testified in opposition to S 983 as well. The prepared statement of the board's executive secretary, Douglas Bell, stressed that the jurisdictional issue is one of collection method, not tax liability. Tax liability was clear for all sales with a destination in the taxing state. The issue, then, is whether states could require the vendor to play a role in the collection task or whether for some kinds of sales the state would be faced with the much more difficult and costly task of collecting from the purchaser. Bell saw no need for federal legislation, since he argued that most of the problems identified in the Willis Report had been resolved, and the compliance issue was, in any case, generally overstated. He reiterated that the California State Board of Equalization

> ...strongly opposes any federal legislation affecting sales and use tax, with the possible exception of extending the use tax collection jurisdiction to include mail order business.18/

Representatives of the State of New Mexico expressed opposition to the bill on somewhat different grounds. Because New Mexico has a broad-based gross receipts tax which includes services more than most states, some of the provisions of the 1980 Mathias bill would restrict that state's ability to collect taxes even more than in states with more traditional sales and use taxes.19/

National Conference of State Legislatures

The National Conference of State Legislatures did not testify at the hearings, but did adopt a position on taxation of interstate sales in 1984. The policy statement supports federal legislation authorizing states to require the collection of use taxes by out-of-state mail order firms.20/

ACIR Survey

Another source of information about the attitudes of states and state revenue officers comes from the ACIR survey on the sales and use tax conducted in September 1984. That survey and the replies are reproduced in Appendix B, but several concerns are worth underscoring. The State of Washington mentioned its concern about revenue losses from both border sales and interstate sales to business firms, particularly service firms, on which use tax was difficult to detect and assess. Thirty-two of the 37 respondents regarded revenue losses from mail order sales as significant. Most saw federal legislation as the best path to resolution.

While their concerns focus on different aspects of the issue, the states, like the business community, speak with a relatively uniform voice, calling for either broader nexus standards in general or else a tradeoff between broader standards and such mitigating provisions as a threshold exemption, an optional combined state-local rate for states with local sales taxes, collection of state taxes only, and other possible modifications to minimize compliance costs. The concerns expressed by state revenue officers include not only erosion of the sales and use tax base but also competitive effects and equity between in-state and out-of-state purchasers. While discounting business claims of high compliance costs, state tax administrators pointed in turn to the cost and inconvenience of attempting to extract the use tax (for which the liability is clearly established) from many individual purchasers rather than a smaller number of vendors.

NOTES

1/ This view was expressed by William D. Dexter, general counsel of the Multistate Tax Commission, in State Taxation of Interstate Commerce and Worldwide Corporate Income, Hearings before the Subcommittee on Taxation and Debt Management Generally, Committee on Finance, U.S. Senate, 96th Cong., 2nd Sess., June 1980, p. 403 (hereafter referred to as 1980 Hearings).

2/ 1980 Hearings, p. 255 and p. 299ff.

3/ Ibid., p. 257.

4/ Ibid., pp. 259-72.

5 Ibid., p. 294.

6/ Senator Mathias, the author of S 983, summarized the changes to the bill

on pages 62-66 of the 1980 Hearings.

7/ Ibid., p. 359.

8/ Ibid., Statement of the Executive Committee of the National Association of Tax Administrators, p. 476.

9/ Ibid., pp. 485-86.

10/ Ibid., p. 407.

11/ State and Local Taxes Report Bulletin, Prentice-Hall, Bulletin #13, September 25, 1984.

12/ Ibid., p. 2.

13/ Ibid.

14/ Ibid.

15/ The argument by Justice Fortas on this issue was cited in Chapter 2.

16/ 1980 Hearings, p. 768.

17/ Ibid., pp. 769-70.

18/ Ibid., p. 896.

19/ Ibid., p. 937ff.

20/ National Conference of State Legislatures, Policy Position on Government Operations, adopted at the Tenth Annual Meeting in July 1984.

Chapter 5

PATHS TO RESOLUTION

The issues surrounding Court-imposed limits on the state and local sales and use tax collection liability for interstate sales have been on the Congressional agenda for 25 years. Since the issue was first raised in 1959, four major Supreme Court decisions have redefined those limits in a fashion not always clear to either taxpayers or tax collectors, while four sets of hearings have produced no legislation. During that period, the fate of the sales and use tax was tied to the fate of the state corporate income tax by both sides--business and state tax administrators. Now the time appears ripe for some action because:

1) the related issue of state taxation of worldwide corporate income on a unitary basis shows signs of approaching resolution;

2) state and local governments are finding that their federal aid dollars are shrinking while the prospects for further devolution of responsibilities are mounting;

3) in meeting those expanded financial responsibilities, state and local governments have increased their reliance on the sales and use tax; and

4) we are seeing rapid growth of interstate sales not subject to sales or use tax, by electronic and other novel means not anticipated in 1959 (PL 86-272) or even 1967 (National Bellas Hess).

Thus, this is an opportune time to reexamine the nexus standards for the sales and use tax, the mainstay of most state governments and an important revenue source for many local governments as well. The need to maintain the integrity of the base and to provide equitable treatment of both in-state and out-of-state sellers, as well as the importance of the tax as a revenue source, all suggest that the nexus standards of National Bellas Hess should be carefully reviewed. In this chapter, we will consider the various avenues of resolution that are available and evaluate each method.

Option 1
A COOPERATIVE SOLUTION

Cooperation was the primary means of collecting sales or use (usually use) taxes from nonresident firms prior to National Bellas Hess, although with a few

exceptions, it took the form of reciprocal arrangements among states. Court judgments of one state must be enforced in another if they do not violate due process. Administrative judgments, which are more common in tax matters, are usually enforced only if there are reciprocal agreements to do so and if the state supreme court has ruled that it is constitutional to assert jurisdiction. While state cooperation takes many forms and works through many groups, formal and informal, we want to examine two particular approaches to cooperation in the sales and use tax area. One involves the Multistate Tax Compact, or by extension, any multistate formal cooperative agreement. The other method is reciprocal collection statutes providing for enforcement of other states' tax judgments for states that reciprocate.

The Multistate Tax Compact and the Multistate Tax Commission

Fear of restrictive federal legislation in the 60s led to a cooperative effort in the area of state taxation--the Multistate Tax Compact and the Multistate Tax Commission (MTC), which came into being immediately following the Willis Report. By 1980 the MTC had 19 member states and 12 associate members.

The 1965 Willis Report, cited in Chapter 3, was highly critical of the lack of uniformity and cooperation among states in both income and sales/use taxes, which the report blamed for confusion, uncertainty, and over and under-taxation. The MTC set out to remedy as many of these flaws as possible in order to forestall federal legislation which member states expected would place even narrower limits on their ability to collect taxes from nonresident firms doing business in their states and cost them tax revenue--particularly in corporate income taxation.

Another concern that led to the formation of the MTC was a proposed federal model sales and use tax law in the 1965 version of the Willis bill, to which the states strongly objected. Voluntary cooperation was suddenly more attractive when seen as an alternative to imposed cooperation.

In 1973, one of the bills (S 2092) considered at the hearings authorized the Multistate Tax Compact and empowered it to serve as an administrative vehicle for any future federal legislation in this area.1/ A number of witnesses representing state government offered support for this bill, but it was not adopted.2/

Reciprocal Agreements

One cooperative approach which has been incorporated in several proposed

bills 3/ is reciprocal agreements among contiguous states. Under such authorized formal reciprocal agreements, states would be allowed to collect use tax on sales, especially border and mail order sales, that were made to buyers in another state and remit the tax to the destination state. The limitation of reciprocal agreements to contiguous states brought forth some strong criticism, particularly from Alaska, which has local sales taxes and does not wish to inflict restrictions on any future state level sales and use tax if one should later be adopted.4/ Although the 1980 version of the Mathias bill deleted the limitation of reciprocal agreements to contiguous states, it also considerably reduced the effectiveness of such reciprocal agreements by limiting its application to firms with a specifically defined business location in the destination state and also by adding a $20,000 *de minimis* provision.

Reciprocal agreements are not new. Currently 41 states and Washington, DC, have reciprocal tax collection statutes which require their courts to recognize and enforce the liability for taxes imposed in other states. Several other states have less formal arrangements or court decisions which permit reciprocity.5/ However, the ability to collect based on a tax administrator's assessment rather than a court judgment in the destination state is less clear. In addition to a reciprocity statute, it would require that the state courts rule that it is constitutional to assert the jurisdiction to tax, and it is likely that the ruling would not be the same in all states.

Limitations of Cooperative Approaches

While bilateral cooperative agreements have some potential usefulness in addressing border sales and in reducing auditing costs, they do little to address the problem of mail order sales by firms not meeting the current nexus standard. In general, the cooperative approach can be fruitful in many ways but, because it cannot modify nexus standards directly, cooperation cannot resolve the problem of taxation of interstate mail order sales. The MTC has proved to be a useful vehicle for promoting uniformity, and reciprocal agreements have some limited usefulness in border sales, collection, and audit. However, neither approach can by itself return states to the nexus standards before *National Bellas Hess*; that can only be overturned by federal judicial or legislative action.

Survey Results on Cooperative approaches

The ACIR 1984 survey results generally supported the view that cooperative

agreements have very limited value in addressing the problems created by National Bellas Hess. The question was asked:

> Do you believe that interstate cooperative agreements would be effective in substantially reducing the amount of revenue loss due to mail order sales into the state?
>
> The replies were:
> Yes 14 (two qualified) No 15 (four qualified)
> Maybe 7
>
> Comments included:
>
> Cooperative agreements could not resolve the nexus or jurisdictional issue (four responses);
> They would work only with all states participating, which the MTC has been unable to attain in 19 years (two respondents);
> Concerns by several respondents about administrative costs and difficulties.
> Even those who reacted positively to the idea often expressed a need for federal legislation as well.5/

Option 2
A JUDICIAL SOLUTION

The second possible path to a resolution of the problem of untaxed mail order sales is a court challenge to the existing nexus standards. It is possible to combine a judicial solution with interstate cooperation to devise an approach to the issue which bypasses Congress entirely. In order to evaluate the feasibility of a challenge the existing standard, the standards for adequate linkage or minimal connection in National Bellas Hess must be reexamined carefully.

Changing Sales Methods and Nexus

James Nelligan, Pennsylvania deputy secretary for taxation, suggests one basis on which tax administrators might challenge National Bellas Hess. One of the ways to meet the minimum linkage requirement establishing liability to collect the tax was advertising merchandise for sale in newspapers, on billboards, or by radio or television in the destination state of Illinois (a criterion which the National Bellas Hess Company did not meet since its advertising in Illinois was by catalog and mailed flyers only.) One of the major changes since 1967 is the much wider use of electronic advertising media, which respect no state borders. Nelligan observes that the Court might be asked to reconsider the criteria in the light of changed circumstances:

> It is highly doubtful that any agent, any salesman, any canvasser, or any other type of representative, working out of any office, any distribution house, any warehouse or any other place of business within a state can be as persuasive and effective as the great electronic super-salesman--the television. With its color, its graphics, its gimmicks, its tunes, its nostalgia, and yes, even its sex, it invades the privacy of millions of homes every hour of every day of every week of every year with a sales pitch that reaches male and female, young and old, rich and poor, thin and fat, without discrimination. If this does not constitute that definite link or minimum connection in the Supreme Court's criteria, then I will probably never understand what does.6/

Similarly, the Court has not yet been asked to rule the nexus implications of such novel forms of "business presence" as computer terminals in factory cafeterias or linkage to home computers. Such changes in sales methods, especially mail order sales, could conceivably provide a basis for challenging current nexus standards based on National Bellas Hess.

Several states are currently considering state legislation imposing restrictions on the right of nonresident firms to sue for collection of payment from customers in their state courts when the firm is not registered with the state's tax commission. If any of these bills are enacted, they would also provide a court test in a somewhat different context from the challenge to nexus standards just described.

If the nexus standard of National Bellas Hess were reversed or modified by a court decision, implementation of the collection requirement could be feasible through a combination of state court actions and interstate cooperation, either formally or informally, bilaterally or through multistate arrangements.

The primary advantage of a judicial approach is that it does not involve Congressional action on a state tax issue. This avoids "re-linking" the use tax to corporate income tax or other issues on which business would like to seek a quid pro quo in the political process. It also has considerable appeal from a federalism standpoint; Congress would not be placed in a position of deciding such issues as a de minimis threshhold, a collection cost allowance, a uniform state-local rate, or other issues which require changes in existing diverse state and local sales and use tax statutes.

Survey Results on a Judicial Solution

Some of the drawbacks to a judicial solution emerged in the ACIR survey in

the fall, 1984. In response to the question

> Does your state have any plans to take legal action to overturn National Bellas Hess?
>
> Only one state responded with an unqualified yes. One other state said that it would consider such action if the right case came along, and several others volunteered to file an amicus curiae brief or support a sister state in such action. In reply to the final question, asking which of the three approaches (federal legislation, judicial solution, or cooperative solution), only two states listed a judicial solution as their first choice. One respondent suggested that both judicial and legislative solutions should be pursued, but ventured a legal opinion that it was unlikely that National Bellas Hess could be overturned through litigation. Another suggested that litigation might publicize the importance of the issue, but was not optimistic about resolving the matter in that fashion.

In general, the survey results seemed to suggest that litigation would be a slow and costly process in which many possible criteria for nexus would have to be tested, perhaps one at a time, in order to establish a clear definition of the standard.

The Court is Reluctant

In the 1980 hearings, one business representative argued that the state corporate income and sales/use tax issues were unlikely to be resolved in court, pointing out that the U.S. Supreme Court had refused to hear some important cases, and even when it did hear those cases little was done to bring order out of chaos.9/ The Court itself has suggested in both Moorman Manufacturing Company v. Bair in 1977 and again in Mobil Oil v. Vermont in 1980 dealing with corporate income taxes, that the task of establishing jurisdictional standards belongs more appropriately to Congress.

In the Moorman case, the Court framed its reluctance to deal with such matters in Commerce Clause terms:

> It is clear that the legislative power granted Congress by the Commerce Clause of the Constitution would amply justify the enactment of legislation requiring all states to adhere to uniform rules for the division of income. It is to that body, and not this Court, that the Constitution has committed such policy decisions.10/

The same point was made in National Bellas Hess, this time specifically in the sales and use tax area, in the majority opinion:

> Under the Constitution, this is a domain where Congress alone has the power of regulation and control.11/

Thus, while a judicial solution is possible, such an approach has some inherent weaknesses from the practical standpoint. First, the Supreme Court is reluctant to address this issue further. The Court has extended a clear invitation for Congress to carry out its Constitutional responsibilities in interstate commerce in several cases. Second, the states are concerned about the cost of litigation as well as the problem that litigation is more likely to "nibble at the edges" with gradual but specific expansions of jurisdictions rather than fully overturning National Bellas Hess.

One of the advantages of a judicial approach is also a drawback from a different perspective. A judicial approach is inherently silent on such issues as collection cost allowances, *de minimis* rules, and uniform state-local rates. These issues would not arise in a court case and are unlikely to be successfully addressed by simultaneous modification of statutes in 46 states and Washington, DC. If mail order businesses are concerned about protecting the interests of small firms and minimizing net compliance costs, those interests might be better served by a legislative approach.

Option 3
FEDERAL LEGISLATION

A legislative solution to the problem of the limited jurisdictional reach of the state sales and use tax has been on the Congressional agenda for 25 years with no result. Two roadblocks, closely related, have stood in the way of progress. First, it has been virtually impossible to devise a bill on which tax administrators and business interests could agree. Second, and representing one of the major areas of business/tax administrator dispute, in almost every proposed bill the nexus standards for sales and use tax were linked to the equally intractable issue of state corporate income taxes on multijurisdictional corporations.

Separating Sales and Use from Corporate Income Tax

State tax administrators generally preferred to have no legislation rather than break the link between the two issues, because they hoped to get broader nexus standards for the sales and use tax as a tradeoff for expected new limitations on state use of the unitary method of apportionment for the corporate in-

come tax. Within the sales and usetax area, there was potential for compromise, with a much broader definition of nexus offset by a de minimis rule; but as long as the two issues were linked, legislative relief was impossible.

When Senator Mondale introduced his bill, S 2811, in 1973, he argued persuasively in favor of separating the two issues, stating

> ...with the introduction of this bill, I propose to separate the legislative consideration of these wholly unrelated issues. My intention is to direct complete and undivided attention toward solution of the most compelling aspect of state and local taxation of interstate businesses, which our hearings have indicated is capable of quick resolution. Indeed, a review of the developments since 1961, when Congress first directed that a study be made of interstate sales and use taxes, shows that inclusion of remedial provisions on this issue in an omnibus state taxation bill has merely resulted in this particular issue being shelved rather than receiving the prompt attention that it deserves....There are some problems in the sales and use tax field that are different from those found in the income tax field and consequently require different solutions.10/

As it appears that the issue of unitary taxation of corporate income is approaching resolution, the opportune moment for reconsidering Senator Mondale's argument may have arrived. That is, the first requirement of a satisfactory legislative solution is to limit legislation to correcting problems in interstate sales and use taxation only. That separation of issues still may prove a major stumbling block to legislation, as it has in the past 20 years.

Two Approaches to Federal Legislation

We will be examining two alternative approaches to federal legislation. One legislative approach would offer modified nexus standards which negate National Bellas Hess and consider mail order catalogs, regular advertising in media, and other attempts to regularly penetrate a state's market by mail order firms who deliver in the destination state as adequate nexus. Such legislation would have to address the de minimis and single state rate issues, and might conceivably address the practice of a collection cost allowance to firms or other collection cost issues as well. The other approach is a national mail order tax on all interstate mail order sales not presently liable to collect the tax.

Still a third approach, taxing interstate mail order sales by state of origin rather than state of destination, was not considered because it meets

neither the competitive nor the compliance cost concerns very effectively. Consumers would be faced with out-of-state suppliers with different sales tax rates, and the burden of compliance costs, while lower on the seller--who has only one state's rate and exemptions to deal with--is much higher on the buyer, who must comply with different sales taxes in various states of origin. Thus, this solution would not satisfy consumers, nor competing retailers, nor mail order firms. In addition, it would encourage migration of mail order firms to no-sales-tax or low-sales-tax states for tax reasons only.

The first approach, legislation to modify nexus standards, is capable of addressing all the economic issues raised in Chapter 2--tax revenue, competition, and compliance costs. It suffers from two drawbacks that were identified in the discussion of a judicial solution. First, it involves Congress in modifying not only a Supreme Court decision--a not uncommon practice--but also in imposing some uniformity on state sales and use tax statutes. Thus, the proverbial federal camel is intruding a perhaps unwelcome nose into the carefully guarded tent of state autonomy in the sales and use tax area. Second, it is likely that other, peripheral issues will be drawn into the discussion and find their way into any legislation--always a risk in resorting to the legislative process.

The second alternative, a national mail order tax, was suggested by an industry source primarily concerned with minimizing compliance costs. This method would create a national tax (at a single uniform rate) on interstate mail order sales delivered to purchasers in states where the vendor does not meet nexus standards, however defined. The revenues from such a national tax would be distributed among the states on a basis of their estimated share of such sales.

A national mail order tax raises some issues not previously encountered. First, unlike the first legislative approach we described, it does not require a redefinition of nexus, which simplifies legal concerns. Second, it would be a first federal step into a traditional state and local tax area, which would raise strong objections in many quarters. Third, as we recognized in Chapter 2, there is no simple and accurate way of apportioning mail order sales among states. Any proxy is imperfect, and different proxies--population, personal income, retail sales, urban-rural mix--correct for the errors of other measures but introduce their own inaccuracies. Finally, a uniform national rate only partially corrects the competitive inequities identified in Chapter 2, since the rate will be higher than in some states and lower than in others. In the

case of the five states with no state sales tax, a genuinely uniform interstate mail order tax would require that it be imposed on sales to their residents as well, creating a competitive disadvantage for mail order firms relative to in-state sellers. The issue of how to address taxation of mail order sales to residents of nonsales tax states is not an insurmountable barrier, but it does raise difficulties for what is otherwise a relatively simple tax.

Survey Results: Federal Legislation

The ACIR survey of September 1984 showed overwhelming support among state tax administrators for federal legislation as a way of addressing the jurisdictional reach of the sales and use tax. Of 37 respondents to the question, "Would your state support federal legislation designed to negate *National Bellas Hess*?" 34 said yes, two offered a qualified yes, and only one said no. Comments offered some qualifiers. One state respondent urged that the legislation go beyond just requiring information and impose the collection liability on out-of-state mail order firms. Another wanted to be sure that the Constitutional rights of taxpayers, including mail order houses, were protected in any legislation. A third respondent wanted to be sure that any such legislation was limited to the sales and use tax issue with no restrictions on the states' taxing authority in other areas.

ISSUES IN FEDERAL LEGISLATION

If federal legislation is enacted to permit states to require out-of-state mail order firms to collect and remit sales or use taxes to states in which they have a more limited business presence than the standard as established by *National Bellas Hess*, there are several subsidiary issues to be considered. The first issue is the method of enforcement. The methods of enforcement lie along a continuum from state courts and voluntary bilateral cooperation between states, to multistate agreements, to federal court enforcement, to a federal tax on interstate mail order sales remitted to states on a formula basis.

Another major concern has been minimizing compliance costs, particularly for small businesses. Either a national mail order tax or an origin principle tax for interstate mail order sales would address the compliance cost issue, but raise some other difficulties which have been considered above. In the context of legislation to modify nexus standards, four possible techniques to address compliance cost concerns are (1) a *de minimis* rule; (2) a single rate for

each state, either the state rate only or a uniform combined state/local rate within a state; (3) requiring all states to provide a collection cost allowance; and/or (4) requiring greater uniformity in the schedule of exempt items, the list of exempt buyers, or both. Any or all of these would reduce compliance costs for multistate sellers.

Other matters to be addressed in devising legislation include MTC's suggestion of an origin collection "backup," and amnesty for prior taxes.

Methods of Enforcement

Prior to National Bellas Hess, any state which attempted to collect use tax through a nonresident seller would have recourse to state courts, serving a judgment on the nonresident firm through the taxing state's secretary of state. This was the procedure followed by Illinois in attempting to recover use taxes on purchases made by Illinois residents from Bellas Hess. Its success would be dependent on the voluntary cooperation of the sister State of Missouri in which the firm was domiciled.

Several levels of enforcement provision can be considered. We have identified four along a continuum of increasing certainty and ease of collection but also of increasing federal intrusion into the administration of a state and local tax. The first is to return to the *status quo ante*, relying on state courts and voluntary cooperation. The second, only slightly more certain and involving more federal control, is Congressionally authorized multistate cooperative arrangements to collect use tax on a reciprocal basis. One variant of such an approach was described in Chapter 3; one of several bills considered in the 1973 hearings was to authorize a multistate tax compact. The third enforcement method is the use of federal courts, which presumably would require only one test case to guarantee future enforcement. The final approach, a national mail order tax, was discussed above. The first three types of enforcement methods represent a continuum of increasing certainty on the one hand and increasing federal intrusion on the other.

De Minimis Rule

A *de minimis* rule was suggested at various times by a number of participants and was incorporated in the Mondale bill and in the most recent version of the Mathias bill. Such a resolution of the small business compliance problem was suggested at the 1973 hearings. One observer argued in that hearing that a

sales test to relieve small business, instead of the business location test currently in use, would also be helpful to smaller states, who more often lose revenues on the business location tests.13/ The witness felt that sellers are more likely to meet the business location test in larger states with an office, stock of goods, and/or employees located in those states.

The concept of a *de minimis* exemption generates little opposition, although some firms who do meet current nexus tests argue that discrimination on the basis of size is inappropriate, since no such discrimination is made in the case of in-state firms. Such a rule does seem to be well suited to addressing small business compliance costs, although there is little agreement on the size of the threshold. Some suggest that a combined test--meeting either a national threshold or a state threshold rather than a single test--would better safeguard the revenues of less populous states. A proposal of $20,000 in the Mondale bill in 1973 met cries of both "Too low!" and "Too high!"13/ More recent suggested figures for a state sales threshold range from $10,000 in a bill proposed by the California State Board of Equalization to $250,000 in a proposal drafted by the State of Washington Department of Revenue,14/ while national thresholds as high as $5-$10 million in sales have been discussed. In 1980 testimony, the Direct Mail Marketing Association suggested a scale which would vary with the destination state's income and population.15/

Two guidelines from neither tax collector nor mail order industry sources give some measure of what is considered "small" in terms of sales level. The Small Business Administration uses sales of $12.5 million as a cutoff point in defining small business. The Peat, Marwick 1985 study uses three classes of firm size; small (sales under $1 million a year), medium ($1-10 million) and large (sales > $10 million).16/

In general, most of the testimony and proposed legislation uses a dollar figure to define a *de minimis* threshold, but the possibility of indexing or providing other methods of periodic reassessment needs to be considered.

The choice of an appropriate threshold for a *de minimis* rule may be the most difficult issue to resolve. Both compliance costs and collection costs for states would be minimized by a high threshold, which excludes a large number of small firms yet covers the bulk of interstate mail order sales. Chapter 2 identified the numbers of firms exempt and percentages of sales covered for various national sales thresholds. The pattern of size distribution in the industry, with most of the volume of taxable sales being made by a fairly small

number of sellers is not unique to the mail order segment of retail trade, but rather is typical of state revenue administration experience. Due cites data from Kentucky indicating that the top 1% of retail sellers in that state (482 firms) account for 45% of sales tax revenue, while the smallest 81% of vendors only produce 11% of revenue. In Utah, 1% of accounts generate 40% of the revenue.17/

Thus, from the compliance cost standpoint, a high threshold is desirable. From the revenue standpoint, a more moderate threshold would represent a compromise position, since there is additional collection cost in dealing with many small vendors and most revenue comes from larger vendors. Finally, from the standpoint of competitive equity, a lower threshold would put more firms on an equal tax footing, but too low a threshold would unduly burden small interstate mail order firms and tip the competitive playing field in the opposite direction. It would be very desirable to have a current and independent accounting estimate of compliance costs relative to sales volume specifically for interstate mail order sales (since the two Peat Marwick studies cited in this report both deal with in-state firms) before establishing a legislated _de minimis_ threshold level that attempts to balance competitive, revenue, and compliance cost concerns.

Combined Uniform Rate

The notion of a combined uniform state/local rate has been incorporated in most proposed legislation since 1970. The most popular variant is that developed in Louisiana and known as the Traigle Plan, which was discussed in Chapter 3. Such a combined rate simplifies compliance for the out-of-state firm, which would only have to apply 46 rates (or at most 51, if the five remaining states adopt a sales tax) instead of more than 7,000.

The complexity of devising such a rate--weighted average, a minimum combined rate, or other methods--should not be treated lightly. There is no simple panacea. An average would over-tax in some local jurisdictions and under-tax in others. Imposing on states the requirement to develop such a combined rate could be considered coercive. The failure to apply use tax to intrastate sales (for example, a New York City resident with a 4.25% local tax escaping local use taxes on purchases made elsewhere in New York State) would raise some questions about equitable treatment of in-state and out-of-state sellers, particularly since large interstate mail order firms who meet current nexus standards collect lo-

cal use tax in areas where they meet local nexus standards. If some plan for single rates for each sales tax rate were adopted, these difficult issues would have to be worked out in legislation, weighing the costs and benefits of each alternative.

An alternative would be to limit such collections to either the state tax only or to combined state-local taxes only when the local tax is universal within the state and at a uniform rate. While there are some difficulties in dealing with the single rate issue, the concept of reducing the number of rates to 46 does not appear to be a major source of conflict between business and state tax administrators, although there is certainly concern about protecting local interests in sales and use tax revenue.

Collection Cost Allowance/More Uniform Exemption Lists

Yet another approach to compliance or collection costs is more direct--to require states to provide an adequate allowance to firms to cover the cost of compliance in exchange for broadening the collection requirement. At present 26 states provide some such allowance at varying rates, usually a percentage of tax collected in the 1-3% range. (See Chapter 2 for more detailed information on collection cost allowances.) If such a requirement were part of federal legislation, it would wipe out the revenue gains for those jurisdictions not presently offering such allowances, as well as those allowing only minimal allowances, since equity would require that these states extend such a collection cost allowance to instate firms who do not currently receive such a rebate, or receive a much smaller allowance.

The Peat Marwick 1985 study found that keeping track of exempt items and exempt buyers was a major element in compliance costs, particularly burdensome for small sellers. Thus, an alternative (or additional) way to address compliance costs is to simplify or make more uniform the exemption lists. States, of course, would not be enthusiastic about sacrificing any prerogative in this area; the schedule of exempt items such as food and prescription drugs, and exempt buyers such as charitable institutions, reflects a state consensus both on the desired degree of progressivity and on other desired social goals, such as encouraging home ownership or subsidizing charitable activities. Like other elements of proposed federal legislation, both these suggestions are vulnerable to criticism as excessive federal intrusion into the design of a state tax.

Mixed Origin/Destination Principle

The Multistate Tax Commission has recently put forth an alternative proposal for an "origin backup" concept, designed to ensure that sales are taxable in either the origin or destination state. Under this proposal, states which enacted such a modification to their sales and use taxes would only apply it to sales not subject to a collection liability in the destination state. Thus, the origin-as-fallback approach would ensure that the sale would be taxable primarily in destination states, and only in origin states as a residual. A similar suggestion was made by Hellerstein at the 1973 Hearings,18/ and the "either destination or origin" approach to interprovincial sales taxes in Canada was suggested in a 1971 presentation at NATA's annual conference in Vancouver, BC.19/

This proposal mixes origin and destination principles. The consumer would still be subject to some distortion in choice as well as much confusion about how much tax to include on the order; at present the consumer only needs to know the sales tax laws of his state of residence. There would be a tendency for mail order firms to migrate to no-sales-tax states, or low-sales-tax states, to minimize the tax and compliance cost burden. Thus, while the proposal offers some attractiveness of simplicity, and does generate some sales and use tax revenue, reduce competitive inequity, and lower compliance costs, it also introduces some distortions in consumer choice and location and adds to the consumer's cost of compliance.

Amnesty

Most of the bills proposed during the last two decades which extended the jurisdictional reach of the sales and use tax in any way incorporated an "amnesty" provision. Such a provision exempts sellers from the liability for collecting and remitting prior sales and use tax if they had not met the business location test prior to that bill. An amnesty clause would be necessary for the protection of business firms who might otherwise be exposed to large and indeterminate tax liabilities.

SUMMARY

There are three paths to resolving the issue of equitable taxation of mail order sales; cooperative agreements among states, litigation leading to the reversal or qualification of the nexus standards of National Bellas Hess, or fed-

eral legislation. While a cooperative approach has much to commend it, cooperation cannot resolve problems of defining nexus standards without either litigation or legislation. Litigation may resolve nexus questions on a piecemeal basis or without addressing important concerns in the area of compliance costs. Federal legislation can provide a more general solution to all the issues raised, but potentially at a cost in terms of federal involvement in the design of state tax systems. If such legislation is enacted, it should modify the current business presence or nexus test to take account of changes in the industry since National Bellas Hess, supplementing such a broader business presence test with a sales test or de minimis rule that exempts vendors with sales below a certain minimum figure. Legislation should also simplify compliance by providing for some variant of a single uniform state/local rate in each state, or by imposing a required collection cost allowance on all jurisdictions.

Enforcement can be provided at various levels of intensity, ranging from state courts and voluntary cooperation through multistate compacts or federal court enforcement to a federal tax on interstate mail order sales remitted to the states. This array of enforcement techniques reflects a tradeoff between certainty of collection and degree of federal intervention.

An origin principle for residual tax liability is a possible but not essential alternative. Protection from retroactive assessment of newly created tax collection liabilities must be provided to sellers.

NOTES

1/ S 2092 (introduced by Senator Magnuson) is reprinted on pages 36-65 of the 1973 Hearings.

2/ Among the states with officials testifying in support of S 2092 at the 1973 Hearings were Washington, Florida, Alaska, Idaho, and Oregon.

3/ All of the bills in both 1973 and 1980 had some type of reciprocal collection agreement provision.

4/ 1973 Hearings, p. 128.

5/ Commerce Clearing House, State Tax Guide, Volume 1, p. 69 (September 1984 update).

6/ Questionnaires and replies are given in Appendix B.

7/ Nelligan, James, "The States' Need to Address Interstate Sales Tax Evasion--A Federal Proposal," paper presented at the 52nd Annual Meeting of the

National Association of Tax Administrators, June, 1984.

8/ Appendix A.

9/ 1980 Hearings, p. 708.

10/ Moorman Manufacturing Company v. Baer, 437 U.S. 267.

11/ National Bellas Hess v. Illinois Department of Revenue, 386 U.S. 759, 1967.

12/ Statement by Senator Walter Mondale in the Congressional Record, December 13, 1973, p. 41391.

13/ 1973 Hearings, p. 319.

14/ Copies of four proposals for federal legislation--one drafted in 1978 and 1984 drafts from the states of New York, Washington, and California, are available from the New York State Department of Taxation and Finance in unpublished form. Statements in the text are based on that material.

15/ 1980 Hearings, pp. 291-92.

16/ Peat, Marwick and Mitchell, "A Comparative Analysis of Sales Tax Compliance Costs for Small Business," study performed for the Small Business Administration (unpublished), 1985.

17/ Due, John and Mikesell, John, "State Sales Tax Structure and Operation in the Last Decade--A Sample Study", National Tax Journal, Vol. XXXIII, No. 1, pp. 32-33.

18/ 1973 Hearings, pp. 150-53.

19/ Perry, Charles A., "Interprovincial Cooperation in the Administration of Sales Taxes," in Revenue Administration; Proceedings of the Thirty-Ninth Annual Conference, National Association of Tax Administrators, 1971, p. 140.

Appendix A

ACIR RECOMMENDATIONS ON TAXATION OF MAIL ORDER SALES

Recommendation 2 from
Local Revenue Diversification:
Income, Sales Taxes, and User Charges,
A-47, October 1974.

Simplifying interstate sales tax liability for firms doing business in a state where no place of business is maintained.

The Commission concludes that the more prevalent use of local sales taxes, coupled with variations in local sales tax rates, necessitates Congressional action to ease compliance problems for vendors in interstate commerce and to protect in-state business from the potential inroads of tax free competitors whose place of business is out-of-state.

The Commission therefore recommends that Congress explicitly authorize the state government to impose a sales tax on firms making sales in states where they maintain no place of business and that the sales tax be equal to the state rate plus a single local rate. The Commission further recommends that the states adopt a formula to distribute the local sales tax portion among local governments.

The continued spread of local sales taxes coupled with variations in local tax rates raises the issue of excessive compliance costs for firms transacting business in states where they maintain no place of business. To comply with existing law, each firm would have to subdivide its business activity by locality and then apply the applicable rate to this share of its total activity. Quite clearly, this requirement can become cumbersome at best as the mere collection of applicable local sales tax rates can be a considerable chore--particularly as the number of jurisdictions and rate variations is increased. It is seemingly impossible for all save the largest of enterprises.

Much of the difficulty arises in determining where the sale occurs--that is, who is entitled to the tax. The "pooling" approach is the simplest arrangement; under it, all sales made other than in jurisdictions where the firm has an actual place of business are taxed by the state at a supplementary local rate, and this amount returned to all local units on the basis of some formula.

The approach outlined here is based on the "Louisiana Plan" which has been incorporated in the Mondale Bill (S 2811). The principle of a uniform state-local sales and use tax rate has generated fairly widespread support. This would, in effect, overturn the Supreme Court decision rendered in the National Bellas Hess case and extend the states' sales tax reach to those firms doing business in states where they do not maintain a place of business.

This recommendation parallels the Mondale bill in calling for a uniform and simplified procedure to enable vendors to more easily comply with state and lo-

cal sales taxes. For the purposes of this study, then, it resolves the difficulties created by increasing the number of local sales tax jurisdictions, each with some, albeit constrained, rate setting authority. This recommendation differs from the Mondale approach in that the latter would shrink the sales tax reach of those states that do not elect the "uniform state and local tax" as defined in the bill.

Recommendation 6 from
The ACIR Docket Book, 73rd Meeting, April 21-23, 1981,
Tab B, p. 16 (not adopted).

The Sales Tax Issue

The Commission reiterates its earlier recommendation that Congress require out-of-state vendors, with no establishment in the taxing jurisdictions, to collect a nondiscriminatory sales tax on sales made into the state. A nondiscriminatory state rate for this purpose should include a standardized local rate not greater than the average of existing local rates. This proposal would not be retroactive in its application. Furthermore, the states may provide for certification of sales made by out-of-state vendors into the taxing state.1/

This provision would remove the constraints imposed on states by the National Bellas Hess decision.2/

Pro. The additional state revenues gained by the closure of this gap would help to offset the loss of revenue that could result from a decision of the Congress to restrict state taxation of foreign source income.

This proposal would require out-of-state vendors to collect sales taxes just as "main street" merchants presently do. Due both to the very limited scope for state reciprocity and to the negative U.S. Supreme Court ruling in National Bellas Hess, the states have no effective means for eliminating the unfair tax advantage enjoyed by out-of-state vendors.

Con. This sales tax proposal would provide at best only a partial offset for the loss of income that could result from Congressional curtailment of state income tax authority over foreign source income. The sales tax proposal should stand or fall on its own merits--not as a political trade-off for state income tax reforms.

1/ ACIR, Local Revenue Diversification: Income, Sales Taxes and User Charges, A-47, Washington, DC, U.S. Government Printing Office, October 1974.

2/ National Bellas Hess, Inc. v. Illinois Department of Revenue, 386, U.S. 753, 1967.

Appendix B

MAIL ORDER SURVEY OF STATE REVENUE COMMISSIONERS

Initial Questionnaire

August 31, 1984

TO: State Revenue Commissioners:

In June, you passed a resolution at the Des Moines meeting of NATA commending a study of the loss of sales and use tax revenue from mail-order sales. As we embark on this study, we need your input. Your response to the enclosed questionnaire will be most helpful to us as we tackle this issue.

The purpose of this questionnaire is to elicit opinions and informed observations from state officials most directly concerned with the collection of sales and use taxes. Your cooperation will be extremely important to the successful completion of this study.

Please indicate in the space provided whether you would like your response to be kept confidential. Please return the questionnaire by September 20th if possible.

Thank you for your assistance.

SURVEY ON MAIL ORDER SALES/LOSS OF SALES AND USE TAX REVENUE

State____________________ Name____________________________________

Telephone_________________ Title____________________________________

Please keep my responses confidential. Yes________ No________

Number of Respondents: 37

1. Does your state lose a significant amount of sales tax revenue due to the increase in sales made by mail order houses? Yes 32, No 1, Don't know 3. How do mail order sales rank in significance relative to other forms of sales tax evasion or revenue loss in your state?

   "Major, very high, high, significant, top three, second only to border sales" 18 responses; "Not significant" 1 response; "No reply, don't know, or dollar figure" remaining responses.

2. Have you made an estimate of that revenue loss for any recent year? Yes 7, No 30. What is that revenue loss estimate $9-$123 million.

3. What was the basis for that revenue loss estimate?

   Generally, used state share of various national estimates of mail order for direct marketing sales; determined state shares by share of per capita income.

4. How many firms with mail order sales into your state file a sales/use tax return? 10 responses (average 468). Do you keep a record of the number of mail order houses selling into your state which do not pay sales or use taxes? Yes __, No __. If yes, how many such firms have you identified? _____. Has this latter number increased over the last several years? _____. If yes, how much? (Most respondents could not determine.)

5. Do you believe that interstate cooperative agreements would be effective in substantially reducing the amount of revenue loss due to mail order sales into the state?

   12 unqualified yes   7 maybe with comments   11 unqualified no
   2 qualified yes   4 qualified no

   Comments

   Interstate cooperative agreements cannot address the nexus issue.

   ...would depend on the language of the agreement...the problem has not been establishing the taxable nature of mail order sales (such sales are taxable under the use tax). The problem has been identifying the occurrence of such sales and collecting the tax. If states were willing to identify interstate sales deduction by state and user and forward that information to the consuming state, the identification problem would be solved. However, the collection problem of a large number of user-taxpayers owing small amounts would still exist. The only acceptable solution would be if computerized lists of taxpapers and computerized billing were possible. Field collection would be impossible.

   ...the problem is one of the jurisdiction over the mail order firm making the sales.

   ...Not unless cooperative agreements were instituted in all states including those which have no sales tax.

   ...if everyone participated.

   ...too cumbersome and unwieldy to administer.

   Unless federal legislation is enacted, administrative costs would offset a large amount of revenue gains.

   ...not as effective as federal legislation.

   Possibly, but the firms involved, absent legislation, would have to cooperate fully for such an approach to be successful.

   ...if it can be accomplished legally.

   Such agreements would be helpful but not a major solution to the problem.

   We believe that any cooperation would be helpful, however, the answer to the question "substantially" would have to be no.

It is likely that such efforts may be beneficial if an exchange of information or perhaps even an exchange of audit resources is all that is expected. It is unlikely that such efforts alone could substantially reduce revenue loss due to mail order sales.

There is little doubt that cooperative agreements between the states, if pursued vigorously, would be an effective tool in reducing revenue losses due to mail order sales. However, this is a very labor intensive endeavor and on a long-term basis would not prove to be productive.

No, not with restriction placed on states' activities by the U.S. Supreme Court. Should be noted that this state does receive tax on mail order sales from those organizations which have established a jurisdictional presence here, e.g., national retailers with local stores.

Possibly, however, due to the variances in each state's individual statutes, such cooperative agreements would be extremely difficult to create.

Yes, if such agreements could be reached with most other states. However, I do not favor this approach because I think it will be very difficult to reach an agremeent with enough states.

I believe that interstate cooperative agreements would be significantly effective in reducing...revenue loss due to mail order sales into this state.

The problem is one of jurisdiction over the mail order firm making the sales.

6. Does your state have any plans to take legal action to overturn National Bellas Hess?

 1 qualified yes 2 qualified no 34 unqualified no

Comments

If appropriate case can be developed, such action would be taken. We would also support and join any such effort by other states.

The State of ______________ does not have any plans at this time to take legal action to overturn National Bellas Hess; however we will certainly file an amicus brief if a sister state takes legal action.

Yes, we are considering the assessment of tax against some out of state mail order firms, alleging that they have become subject to the __________ tax because of the TV advertising they are buying.

Not at the current time. If we identify the right cases we would certainly pursue. First, we certainly would go all the way if the taxpayer had nexus in ________________. We are analyzing the potential use of the "unitary" concept and its application in this area.

____________________ is currently participating in joint efforts with other northeastern states to limit the impact of National Bellas Hess in the collection of sales tax from mail order houses.

7. Would your state support federal legislation designed to negate National Bellas Hess?

34 yes 2 qualified yes 1 No

Comments

_______________ would actively support such federal legislation and is currently working with other states in developing a coordinated position....

Yes, very definitely. We would lobby our Congressmen and believe that we could get most of them to support legislation, because there are no large mail order firms headquartered in _____________. We could get _________ retailers to lobby in favor of such legislation.

Absolutely. It is ________________'s opinion that federal legislation is mandated to negate the effect of the National Bellas Hess decision.

We believe that federal legislation is necessary to establish Congressional intent in an effort to influence the court to alter its opinion on the issues in National Bellas Hess. There is some risk that federal legislation may stop short of imposing tax liability or collection responsibility on retailers and only provide states with the right to require retailers to provide information on the taxpayers (consumers) in question. Due to the collection problems mentioned above, merely imposing reporting requirements would be an unacceptable solution.

Our position, therefore, is supportive of federal legislation, assuming that such legislation places sufficient reporting and collecting responsibilities on mail order retailers.

...if such legislation addressed only this issue with no restrictions upon the states' taxing authority.

8. Of the three approaches, which do you consider the best way to address this problem?

34 Federal legislation 1 Cooperative Solution
2 Judicial solution (plus one as second choice)

Comments

Federal legislation (should respect) the Constitutional rights of the taxpayers, including mail order houses.

I do not think cooperative agreements are apt to work. I think we should pursue both judicial solutions as well as federal legislation. As a lawyer, I am not optimistic that National Bellas Hess can be overturned, therefore, I favor federal legislation.

The importance of the issue may be brought to light through litigation. However, it is likely that the only way in which National Bellas Hess will be negated will be through federal legislation.

Follow-Up Questionnaire
(19 Usable Replies)

Number Responding		Question and Response
13	1.	How much did your state collect in use taxes on interstate sales in 1982? $4-$123 million. As a percentage of sales and use tax revenue, the range of responses was 0.5%-to 14.5%, with a mean of 6.6% (after collection for automobiles).
12	2.	Of that amount, how much was on purchases of automobiles? $3-$147 million (eight states) (Please indicate if the automobile figure includes in-state as well as out-of-state automobile purchases in the use tax figures, and if so, how much of the automobile figure is in-state and how much out-of-state.) Autos not included in three states.
18	3.	Does your state maintain records on sales which would be taxable, but are exempt because the purchaser resides out-of-state? No, in all but one state. If yes, how much were those sales in 1982? ____ If not, can you supply an estimate of the percentage of total sales that are not taxed solely because the purchaser resides out-of-state? ____
19	4.	What percentage of sales and use tax returns were audited in 1982? The range was 0.5%-10%, averaging 3.21%, with a median of 2.3%. How much revenue was recovered in audit? The responses ranged from $3.5-$146 million. As percent of state revenues, recovery ranges were 0.98%-5.2% with a mean of 2.4% (18 states). How much of that revenue was use tax rather than sales tax? As percent of recovery, it ranged from 3.8% to 75%, with a mean of 52%, and a median of 58%-60% (14 states). Based on audit experience, how significant a source of revenue loss do you consider use taxes on interstate sales to business? "Major, very significant, extremely significant" 5 responses; "significant, substantial" 4 responses; "not significant, insignificant" 2 responses; "did not reply, gave dollar figure only" 9 responses.

Appendix C

METHODS FOR ESTIMATING REVENUE LOSSES AND BASE EROSION

REVENUE LOSS ESTIMATES

The tax revenue loss estimates of Chapter 2 were arrived at in the following manner. First a measure of the aggregate taxable mail order sales base was constructed, based on the sales reported in Fishman's *Guide to U.S. Mail Order Sales, 1983*. Included in this base were sales by consumer product specialty vendors less newspapers ($19.01 billion); sales of general merchandise vendors, excluding Sears, Ward, and Penney, and oil company and airline syndication ($4.062 billion); and 25% of business supplies, trade publication subscriptions, and generalized mail order marketers sales to business ($6.455 billion), for a total base of $29.527 billion. This figure was then projected to 1985 by multiplying by 1.1881 (average rate of growth of 9% compounded for two years).

Second, this base was distributed among the states on two alternative patterns, one based on the distribution of sales of Sears, Ward, and Penney, and the other on the basis of personal income.

Third, the base was adjusted in each state for exemptions of food, clothing, and magazines, and for in-state mail order purchases.

Finally, the state tax rate (or a combined state-local use tax rate in states where all counties or all municipalities use the sales and use tax) was applied to that base to derive estimated tax revenue potential in each state.

These state estimates were then aggregated to give two estimates of total potential tax revenue. The procedure for a hypothetical state is given in Table C-1. A detailed description of each step follows.

The Aggregate Mail-Order Sales Base

The base figure derived above contains some adjustment for taxable business mail order purchases. We estimated that 25% of business purchases by mail order would be taxable that are not currently taxed. The addition for business purchases was based on figures in two industry sources. The figure of 25% is admittedly arbitrary, based primarily on some early studies which suggest that this is about the fraction of state sales and use tax currently borne by business. Certainly the fraction is well under 100% for two reasons. First, some portion of business purchases is not taxable. Purchase of industrial consumables and industrial machinery, for example, are exempt from the sales and use tax in most states. Second, some of these sales are being taxed either by voluntary compliance or by audit, because they are in-state sales, or because the out-of-state vendor meets the business location test and must collect and remit the tax.

State-by-State Distribution of the Base

State-by-state data from the Census were not useful for allocating mail or-

Table C-1

ESTIMATING PROCEDURE FOR A HYPOTHETICAL (AVERAGE) STATE

	1982 Sales Base (U.S.)	$ 29.527
TIMES	State Share of Mail Order Sales	x .02
EQUALS	1982 State Sales Base	591,000,000
TIMES	Correction for Exemption 1/	x (1-.024)
TIMES	Correction for In-State Purchases 2/	x (1-.03)
EQUALS	1982 Corrected State Sales Base	560,000,000
TIMES	Projection Factor to 1985 3/	x 1.1881
EQUALS	1985 Corrected State Sales Base	644,000,000
TIMES	State/Local Combined Tax Rate	x .05
EQUALS	1985 Potential Tax Revenue	$ 33,000,000

Note: National estimated revenue potential in Table 2-3 of text is sum of estimates for individual states with sales and use taxes. Figures used in this hypothetical example are approximate actual values, rounded for convenience; figures for state share in mail order sales, in-state purchase correction, and state and local combined rate are hypothetical. Exemption correction assumes that food but not clothing or magazines is exempt. No correction was made in this example for effects of a *de minimis* provision; that issue is addressed in the chapter.

1/ Corrections for exemption of food, clothing, and magazines where applicable, based on the share of those products in total mail order sales as reported in the *1982 Census of Retail Trade* or in Fishman's *Guide to U.S. Mail Order Sales, 1983*.

2/ The correction for in-state purchases is based on the share of mail order sales originating in that state as reported in the *1982 Census of Retail Trade*. Thus, a state that accounted for 5% of all mail order sales originating would have 5% of its mail order purchases (in addition to Sears, Ward, and Penney, and other corrections already made for taxed mail order sales) excluded from the estimating process as already subject to tax.

3/ Projections made on the basis of average annual rate of growth of mail order sales between 1972 and 1982 in the *Census of Retail Trade*.

der and direct marketing sales among states, because those data are collected and reported by state of origin, not destination. The ACIR estimate distributed taxable sales among the states on the basis of the proportion of the combined sales of the three largest mail order houses (Sears, Ward, and Penney) in each state.

This procedure assumes that a state's mail order and direct marketing purchases cannot be projected simply on the basis of population or per capita income, because urbanization and other factors will also affect mail order and direct marketing purchases. Since the purchases from Sears, Ward, and Penney are subject to sales and use tax, the state-by-state distribution of their sales seems a suitable proxy for a "propensity to purchase by mail order." The resulting pattern differs from what one would predict on a basis of income and population alone, with the less densely populated states of the south and west accounting for a higher fraction of mail order sales while the more urban states of the northeast were less likely to purchase in this fashion.

Since most other studies have allocated mail order sales on the basis of personal income, we developed an alternative distribution measure which allocated sales on the basis of the state's share of U.S. personal income. The base used was the same, but because of the omission of states with no sales tax, and because the different distribution of sales subjected the sales to different mixes of tax rates, the resulting revenue estimates are somewhat different.

Two other adjustments were made to the potential mail order and direct marketing tax base for individual states.

1. Corrections were made for the proportion of mail order sales consisting of clothing for the five clothing exemption states, magazines in the 18 states where magazines are exempt, and sales of food in food exemption states. (Direct marketing sales of clothing were negligible.) The downward adjustment of the base was based on the reported percentage distribution of sales by category in the 1982 Census of Retail Trade for food and clothing and on the share of magazines in mail order sales from the Guide to U.S. Mail Order Sales, 1983.

2. An estimate of purchases from in-state mail order houses and direct marketing firms was subtracted, since these sales would be taxable. This correction was made using the percentage of national mail order sales calculated in the original base. For example, if Texas had 7% of national mail order purchases, we assumed that 7% of the mail order sales originating in Texas (as reported in the 1982 Census of Retail Trade and projected to 1985) were sold to Texans and therefore that fraction of sales was excluded from the sales tax base.

This assumption may err in either direction. A consumer may be more aware of, and therefore more likely to shop from an in-state mail order firm. On the other hand, if tax avoidance is a motive, or if access to an associated retail outlet is not available in-state, then the out-of-state mail order firm may be a more likely supplier.

The State and Local Sales and Use Tax Rate

The tax rate used to estimate revenue loss is a combined state and local

rate for 1985 for states with both state and local sales and use taxes only where the local tax is used by all jurisdictions of a given type (e.g., counties).

Problems with the Business Use Tax Portion of the Estimate

There is no way to determine how large a share of business purchases is taxable. Business purchases that are taxable in many states include furnishings, equipment, and office supplies purchased by such service suppliers as dentists, beauticians, and motels. As we pointed out earlier, some of this tax liability may be voluntarily reported by the purchaser or the vendor, and some may be discovered through audit. In states with limited taxation of services, however, most service suppliers such as those cited do not need to register as vendors and therefore are much less likely to be assessed for use tax. This source of revenue loss may well be either understated or overstated in our estimates.

The 25% of business sales included in the tax base was arbitrary and in any case would vary greatly from state to state, since coverage of business purchases is much more diverse than coverage of consumer purchases. Thus, this component of the estimate must be viewed with some caution, but it could as easily err on the conservative as on the high side.

The final column of Table 2-3 calculates revenue potential as a fraction of projected 1985 sales and use tax revenues. These revenue projections to 1985 are based on the average rate of growth of sales and use tax revenue in each state between 1979 and 1983.

MEASUREMENT OF BASE EROSION

One way to measure erosion of the base is to apply the state tax rate to a base of state retail sales, adjusted to include major taxable services and corrected state by state for exemptions of food, clothing, and prescription drugs. The revenue estimate from this base then can be compared to actual revenues. In most states, actual revenues are higher rather than lower--an indication of the importance of revenues derived from sales not classed as retail, primarily business purchases. This method is used in the ACIR staff effort to measure absolute base erosion mentioned in Chapter 2.

An alternative way of measuring erosion is to examine relative change in the revenue/base relationship from 1972 to 1982--years for which the Census of Retail Trade is available. This relative change is the approach taken in this appendix. The procedure for this estimate is as follows.

1. A correction factor (cf) is developed for each state that reflects rate changes and coverage changes (exemptions of food, utilities, drugs, and industrial machinery) between 1972 and 1982. (For example, adding a food exemption would reduce the base by approximately 19%--the fraction of food in total retail sales--giving a correction factor of 0.81 if no other important changes in the rate and coverage structure had occurred. Projected 1982 revenues would be multiplied by 0.81 to reflect this change.)

2. 1982 revenues were projected for each state as:

$$\frac{\text{1982 Retail Sales}}{\text{1972 Retail Sales}} \times \text{1972 Sales/Use Tax Revenue} \times \text{cf} = \text{1982 Revenue.}$$

This projection assumes that the ratio of other taxable sales and of non-taxable sales to total retail sales did not change significantly during the ten-year period, nor did audit recovery change substantially. Thus, any slippage identified between actual and projected revenue is assumed to reflect increases in untaxed interstate sales and other forms of avoidance and evasion.

The results are presented in Table C-2. Once again, this method under-predicts revenue changes for 26 of the states and Washington, DC, with the extent of under-prediction ranging from only 0.3% in California to 36%-37% in Wyoming and New Mexico.

In the other 19 jurisdictions there is at least some suggestion of base erosion from sources other than additional exemptions.

The problems of measuring erosion of the base are complex and virtually insurmountable. Data from different sources--in this case, state revenue officers versus the Census of Retail Trade--are wildly inconsistent. A substantial but unmeasurable fraction of the sales and use tax falls on business users rather than consumers, but it is virtually impossible to determine how much. Sales which the Census classifies as wholesale are often in fact made to retail consumers and subject to sales or use tax.

Table C-2

ACTUAL AND PROJECTED SALES AND USE TAX REVENUES, 1982, BY STATE

State	Correction Factors (percent)		1982 Projected Revenues (in millions)	1982 Actual Revenues (in millions)	Percent Difference
Alabama	-.011	(drugs)	777	629	-24
Arizona	-.17	(food)	614	801	+31
Arkansas	-.011	(drugs)	367	417	+12
California	+.1875	(rate change)	7,701	7,721	+0.3
Colorado	-.17	(food)	587	613	+4
Connecticut	+.098	(rate, fuel, machinery)	848	1,004	+16
Washington, DC	+.404	(rate, food, drugs)	176	248	+17
Florida	+.215	(rate, fuel, machinery)	2,984	2,784	-7
Georgia	.011	(drugs)	1,001	1,088	+9
Hawaii	none		502	577	+13
Idaho	none		144	146	+1.4
Illinois	-.181	(food, drugs)	2,250	2,343	+4
Indiana	+1.972	(rate, food, drugs)	1,902	1,570	-21
Iowa	-.181	(food, drugs)	430	523	+16
Kansas	-.044	(drugs, fuel)	414	471	+12
Kentucky	-.01	(fuel)	850	682	-25
Louisiana	-.122	(food, drugs)	967	927	-4
Maine	none		258	249	-4
Maryland	-.015	(machinery)	812	797	-2
Massachusetts	+.667	(rate)	765	917	+17
Michigan	-.181	(food, drugs)	1,744	1,844	+5
Minnesota	+.487	(rate, fuel)	1,001	875	-14
Mississippi	-.033	(fuel, drugs)	634	767	+17
Missouri	+.335	(rate, fuel)	1,257	839	-50
Nebraska	+.40	(rate)	384	289	-33

Table C-2 (cont.)

ACTUAL AND PROJECTED SALES AND USE TAX REVENUES, 1982, BY STATE

State	Correction Factors (percent)		1982 Projected Revenues (in millions)	1982 Actual Revenues	Percent Differ-ence
Nevada	+.6225	(rate, food)	394	376	-5
New Jersey	-.015	(machinery)	1,219	1,379	+12
New Mexico	-.125	(rate)	337	534	+37
New York	-.026	(fuel)	4,643	3,197	-45
North Carolina	none		855	780	-10
North Dakota	-.489	(rate, food, machinery*)	98	147	+33
Ohio	+.25	(rate)	1,904	1,819	-5
Oklahoma	-.011	(drugs)	444	482	+7
Pennsylvania	none		2,001	2,229	+10
Rhode Island	+.182	(rate, machinery)	217	200	-9
South Carolina	-.021	(fuel, drugs)	594	647	+8
South Dakota	-.011	(drugs)	164	179	+8
Tennessee	+.284	(rate, fuel)	1,118	1,358	-18
Texas	-.023	(fuel, machinery)	3,063	3,481	+12
Utah	-.011	(drugs)	347	389	+11
Vermont	+.313	(rate, machinery)	66	48	-38
Virginia	-.039	(fuel)	897	671	-34
Washington	+.017	(rate, food, drugs)	1,853	1,892	+2
West Virginia	+.384	(rate, food)	875	781	-12
Wisconsin	+.152	(rate, fuel)	959	961	+0.2
Wyoming	-.011	(drugs)	145	228	+36

*Direct Marketing Association, Direct Marketing Fact Book, Washington, DC, 1983, p. 11.

Appendix D

NATIONAL BELLAS HESS, INCORPORATED, APPELLANT v.
DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS

386 US 753, 18 L ed 2d 505, 87 S Ct 1389 [No. 241]

Argued February 23, 1967. Decided May 8, 1967.

SUMMARY

The Illinois Department of Revenue, acting pursuant to the Illinois statute requiring retailers to collect and pay use taxes, brought an action against the defendant in the Circuit Court of Cook County, IL, to recover use taxes and penalties with respect to merchandise which the defendant had sold to Illinois customers. The defendant, a mail order house, was incorporated in Delaware, had its principal place of business in Missouri, and was licensed to do business only in Delaware and Missouri. It did not maintain any places of business in Illinois; did not have in Illinois any agents or representatives to sell or take orders, to deliver merchandise, to accept payments, or to service merchandise it sold; did not own any tangible property, real or personal, in Illinois; had no telephone listing in Illinois; and did not advertise its merchandise for sale in newspapers, on billboards, or by radio or television in Illinois. Orders for its merchandise were mailed to, and accepted at its Missouri plant, and its merchandise was sent to customers either by mail or by common carrier. Its catalogues were mailed to its Illinois customers twice a year, its occasional advertising flyers were mailed to past and potential customers in Illinois, and its sales to Illinois customers amounted to $2,174,744 during the approximately 15 months for which the taxes in issue were assessed. The Circuit Court entered a summary judgment in favor of the Department of Revenue, and the Illinois Supreme Court affirmed, rejecting the defendant's contention that the application of the use tax statute to it violated the Due Process and Commerce Clauses of the federal Constitution. (34 Ill 2d 164, 214 NE2d 755).

On appeal, the United States Supreme Court reversed. In an opinion by Stewart, J., expressing the views of six members of the court, it was held that since the defendants did no more than communicate with customers in Illinois by mail or common carrier as part of a general interstate business, the requirement that the defendant collect and pay the use tax violated the Due Process and Commerce Clauses.

Fortas, J., joined by Black and Douglas, JJ., dissented on the ground that since the defendant engaged in the business of regularly, systematically, and on a large scale offering merchandise for sale in Illinois in competition with local retailers, and soliciting deferred payment-credit accounts from Illinois residents, the application of the use tax statute was not unconstitutional.

HEADNOTES

Classified to U.S. Supreme Court Digest, Annotated

Commerce § 237; Constitutional Law; § 583--state taxes

1. The test whether a particular state exaction is such as to invade the exclusive authority of Congress to regulate trade between the states and the test for a state's compliance with the requirements of due process in this area are similar.

Commerce § 246--state taxes

2. State taxation falling on interstate commerce can only be justified as designed to make such commerce bear a fair share of the cost of the local government whose protection it enjoys.

Constitutional Law § 583--due process--state taxes

3. The test of whether a state tax law violates the Due Process Clause is whether the state has given anything for which it can ask return.

4. Due process requires some definite link, some minimum connection, between a state and the person, property, or transaction it seeks to tax.

Commerce § 267; Constitutional Law; § 615--use tax--out-of-state mail order house

5. An out-of-state mail order house which has no places of business, salesmen, or other representatives, local advertising, or property in a state, and which communicates with, and makes sales to customers in the state only by mail or common carrier as part of a general interstate business, cannot, under the Commerce Clause and Due Process Clause of the federal Constitution, be required to collect and pay the state's use tax on sales to such customers.

Commerce § 4--commerce clause--purpose

6. The purpose of the Commerce Clause of the federal Constitution is to insure a national economy free from unjustifiable local entanglements.

Commerce § 237--interstate business--regulation

7. Congress alone has the power of regulation and control over taxation of interstate businesses which communicate with and make sales to customers in certain states only by mail or common carrier, without having any places of business, salesmen, or other representatives, local advertising, or property in such states.

APPEARANCES OF COUNSEL

Archibald Cox argued the cause for appellant.
Terence F. MacCarthy argued the cause for appellee.
Briefs of Counsel, p. 1512, infra.

OPINION OF THE COURT

Mr. Justice Stewart delivered the opinion of the Court.

The appellant, National Bellas Hess, is a mail order house with its principal place of business in North Kansas City [386 US 754], MO. It is licensed to do business in only that state and in Delaware, where it is incorporated. Although the company has neither outlets nor sales representatives in Illinois, the appellee, Department of Revenue, obtained a judgment from the Illinois Supreme Court that National is required to collect and pay the state the use taxes imposed by Ill Rev Stat c 120, § 439.3 (1965).1/ Since National's constitutional objections to the imposition of this liability present a substantial federal question, we noted probable jurisdiction of its appeal.2/

The facts bearing upon National's relationship with Illinois are accurately set forth in the opinion of the State Supreme Court:

> [National] does not maintain in Illinois any office, distribution house, sales house, warehouse, or any other place of business; it does not have in Illinois any agent, salesman, canvasser, solicitor, or other type of representative to sell or take orders, to deliver merchandise, to accept payments, or to service merchandise it sells; it does not own any tangible property, real or personal, in Illinois; it has no telephone listing in Illinois and it has not advertised its merchandise for sale in newspapers papers, on billboards, or by radio or television in Illinois.3/

All of the contacts which National does have with the state are via the United States mail or common carrier. Twice a year catalogues are mailed to the company's active or recent customers throughout the nation, including Illinois. This mailing is supplemented by advertising "flyers" which are occasionally mailed to past and potential customers. Orders for merchandise are then mailed by the customers [386 US 755] to National and are accepted at its Missouri plant. The ordered goods are then sent to the customers either by mail or by common carrier.

This manner of doing business is sufficient under the Illinois statute to classify National as a "[r]etailer maintaining a place of business in this state," since that term includes any retailer:

> Engaging in soliciting orders within this state from users by means of catalogues or other advertising, whether such orders are received or accepted within or without this state. Ill Rev Stat c.120 § 439.2 (1965).

Accordingly, the statute requires National to collect and pay to the appellee department the tax imposed by Illinois upon consumers who purchase the company's goods for use within the state.4/ When collecting this tax, National must give the Illinois purchaser "a receipt therefore in the manner and form prescribed by the [appellee]," if one is demanded.5/ It must also "keep records, receipts, invoices, and other pertinent books, documents, memoranda, and papers as the [appellee] shall require, in such form as the [appellee] shall require," and must submit to such investigation, hearings, and examinations as are needed by the appellee to administer and enforce the use tax law.6/ Failure to keep such records or to give required receipts is punishable by a fine of up to

$5,000 and imprisonment of up to six months.7/ Finally, to allow service of process on an out-of-state company like National, the statute designates the Illinois Secretary of State as National's appointed agent, and jurisdiction in tax collection suits attaches [386 US 756] when process is served on him and the company is notified by registered mail.8/

[1-4] National argues that the liabilities which Illinois has thus imposed violate the Due Process Clause of the 14th Amendment and create an unconstitutional burden upon interstate commerce. These two claims are closely related. For the test whether a particular state exaction is such as to invade the exclusive authority of Congress to regulate trade between the states, and the test for a state's compliance with the requirements of due process in this area are similar. See Central R. Co. v. Pennsylvania, 370 US 607, 621-622, 8 L ed 2d 720, 730, 731, 82 S Ct 1297 (concurring opinion of Mr. Justice Black). As to the former, the Court has held that "state taxation falling on interstate commerce...can only be justified as designed to make such commerce bear a fair share of the cost of the local government whose protection it enjoys." Freeman v. Hewit, 329 US 249, 253, 91 L ed 249, 272, 67 S Ct 274. See also Greyhound Lines v. Mealey, 334 US 653, 663, 92 L ed 1633, 1641, 68 S Ct 1263; Northwestern Cement Co. v. Minnesota, 358 US 450, 462, 3 L ed 2d 421, 429, 79 S Ct 357, 67 ALR2d 1292. And in determining whether a state tax falls within the confines of the Due Process Clause, the Court has said that the "simple but controlling question is whether the state has given anything for which it can ask return." Wisconsin v. J.C. Penney Co., 311 US 435, 444, 85 L ed 267, 270, 61 S Ct 246, 130 ALR 1229. See Also Standard Oil Co. v. Peck, 342 US 382, 96 L ed 427, 72 S Ct 309, 26 ALR2d 1371; Ott v. Mississippi Barge Line, 336 US 169, 174, 93 L ed 585, 589, 69 S Ct 432. The same principles have been held applicable in determining the power of a state to impose the burdens of collecting use tax upon interstate sales. Here, too, the Constitution requires "some definite link, some minimum connection, between a state and the person, property, or transaction it seeks to tax." Miller Bros. Co. v. Maryland, 347 US 340, 344-345, 98 L ed 744, 748, 74 S Ct 535; [386 US 757] Scripto, Inc. v. Carson, 362 US 207, 210-211, 4 L ed 2d 660, 663, 80 S Ct 629.9/ See also American Oil Co. v. Neill, 380 US 451, 458, 14 L ed 2d 1, 6, 85 S Ct 1130.

In applying these principles the Court has upheld the power of a state to impose liability upon an out-of-state seller to collect a local use tax in a variety of circumstances. Where the sales were arranged by local agents in the taxing state, we have upheld such power. Felt & Tarrant Co. v. Gallagher 306, US 62, 83 L ed 488, 59 S Ct 376; General Trading Co. v. Tax Commission, 322 US 335, 88 L ed 1309, 64 S Ct 1028. We have reached the same result where the mail order seller maintained local retail stores. Nelson v. Sears, Roebuck & Co., 312 US 359, 85 L ed 888, 61 S Ct 586, 132 ALR 475; Nelson v. Montgomery Ward, 312 US 373, 85 L ed 897, 61 S Ct 593.10/ In those situations the out-of-state seller was plainly accorded the protection and services of the taxing state. The case in this Court which represents the furthest Constitutional reach to date of a state's power to deputize an out-of-state retailer as its collection agent for a use tax is Scripto, Inc. v. Carson, 362 US 207, 4 L ed 2d 660, 80 S Ct 619. There we held that Florida could Constitutionally impose upon a Georgia seller the duty of collecting a state use tax upon the sale of goods shipped to customers in Florida. In that case, the seller had "ten wholesalers, jobbers, or 'salesmen' conducting continuous local solicitation in Florida and forwarding the resulting orders [386 US 758] from that state to Atlanta for shipment of

the ordered goods." 362 US at 211, 4 L ed 2d at 664.

But the Court has never held that a state may impose the duty of use tax collection and payment upon a seller whose only connection with customers in the state is by common carrier or the United States mail. Indeed, in the Sears Roebuck case the Court sharply differentiated such a situation from one where the seller had local retail outlets, pointing out that "those other concerns... are not receiving benefits from Iowa for which it has the power to exact a price." 312 US at 365, 85 L ed at 892, 132 ALR 475. And in Miller Bros. Co. v. Maryland, 347 US 340, 98 L ed 744, 74 S Ct 535, the Court held that Maryland could not Constitutionally impose a use tax obligation upon a Delaware seller who had no retail outlets or sales solicitors in Maryland. There the seller advertised its wares to Maryland residents through newspaper and radio advertising, in addition to mailing circulars four times a year. As a result, it made substantial sales to Maryland customers, and made deliveries to them by its own trucks and drivers.

[5] In order to uphold the power of Illinois to impose use tax burdens on National in this case, we would have to repudiate totally the sharp distinction which these and other decisions have drawn between mail order sellers with retail outlets, solicitors, or property within a state, and those who do no more than communicate with customers in the state by mail or common carrier as part of a general interstate business. But this basic distinction, which until now has been generally recognized by the state taxing authorities,11/ is a valid one, and we decline to obliterate it.

[386 US 759] We need not rest on the broad foundation of all that was said in the Miller Bros. opinion, for here there was neither local advertising nor local household deliveries, upon which the dissenters in Miller Bros. so largely relied. 347 US at 358, 98 L ed at 756. Indeed, it is difficult to conceive of commercial transactions more exclusively interstate in character than the mail order transactions here involved. And if the power of Illinois to impose use tax burdens upon National were upheld, the resulting impediments upon the free conduct of its interstate business would be neither imaginary nor remote. For if Illinois can impose such burdens, so can every other state, and so, indeed, can every municipality, every school district, and every other political subdivision throughout the nation with power to impose sales and use taxes.12/ The many variations in rates of tax,13/ in allowable exemptions, and in administrative and recordkeeping requirements 14/ could entangle National's interstate business [386 US 760] in a virtual welter of complicated obligations to local jurisdictions with no legitimate claim to impose "a fair share of the cost of the local government."

[6, 7] The very purpose of the Commerce Clause was to ensure a national economy free from such unjustifiable local entanglements. Under the Constitution, this is a domain where Congress alone has the power of regulation and control.15/

SEPARATE OPINION

Mr. Justice Fortas, with whom Mr. Justice Black and Mr. Justice Douglas join, dissenting.

In my opinion, this Court's decision in Scripto, Inc. v. Carson, 362 US 207, 4 L ed 2d 660, 80 S Ct 619 (1960), as well as a realistic approach to the facts of appellant's business, dictates affirmance of the judgment of the Supreme Court of Illinois.

National Bellas Hess is a large retail establishment specializing in wearing apparel. Directly and through subsidiaries, it operates a national retail mail order business with headquarters in North Kansas City, MO, and its wholly owned subsidiaries operate a large number of retail stores in various states. In 1961, appellant's net sales were in the neighborhood of $60,000,000, [386 US 761] and its accounts receivable amounted to about $15,500,000.16/

Its sales in Illinois amounted to $2,174,744 for the approximately 15 months for which the taxes in issue in this case were assessed. This substantial volume is obtained by twice-a-year catalogue mailings, supplemented by "intermediate smaller 'sales books' or 'flyers,'" as the court below styled them. The catalogue contains about 4,000 items of merchandise. The company's mailing list includes over 5,000,000 names. The "flyers" are sent to an even larger list than the catalogues and are occasionally mailed in bulk addressed to "occupant."

A substantial part of Bellas Hess' sales is on credit. Its catalogue features "NBH Budget Aid Credit"--which requires no money down but requires the purchaser to make monthly payments which include a service fee or interest charge, and which also incorporates an agreement, unless expressly rejected by the purchaser, for "Budget Aid Family Insurance." The company also offers "charge account" services--payable monthly including a "service charge" if the account is not fully paid within 30 days. The form to be filled in for credit purchase contains the usual type of information, including place of employment, name of bank, marital status, home ownership or rental. Merchandise can also be bought c.o.d. or by sending a check or money order with the order for goods.17/

There should be no doubt that this large-scale, systematic, continuous solicitation and exploitation of the Illinois consumer market is a sufficient "nexus" to require Bellas Hess to collect from Illinois customers and to remit [386 US 762] the use tax, especially when coupled with the use of the credit resources of residents of Illinois, dependent as that mechanism is upon the state's banking and credit institutions. Bellas Hess is not simply using the facilities of interstate commerce to service customers in Illinois. It is regularly and continuously engaged in "exploitation of the consumer market" of Illinois (Miller Bros. Co. v. Maryland, 347 US 340, 347 98 L ed 744, 749, 74 S Ct 535 (1954)) by soliciting residents of Illinois who live and work there and have homes and banking connections there, and who, absent the solicitation of Bellas Hess, might buy locally and pay the sales tax to support their state. Bellas Hess could not carry on its business in Illinois, and particularly its substantial credit business, without utilizing Illinois banking and credit facilities. Since the case was tried on affidavits, we are not informed as to the details of the company's credit operations in Illinois. We do not know whether it utilizes credit information or collection agencies, or similar institutions. The company states that it has "brought no suits in the state of Illinois." Accepting this as true, it would nevertheless be unreasonable to assume that the company does not either sell or assign its accounts or otherwise

take measure to collect its delinquent accounts, or that collection does not include local activities by the company or its assignees or representatives.

Bellas Hess enjoys the benefits of, and profits from the facilities nurtured by the State of Illinois as fully as if it were a retail store or maintained salesmen therein. Indeed, if it did either, the benefit that it received from the State of Illinois would be no more than it now has--the ability to make sales of its merchandise, to utilize credit facilities, and to realize a profit; and, at the same time, it would be required to pay additional taxes. Under the present arrangement, it conducts its substantial, regular, and systematic business in Illinois and the state demands [386 US 763] only that it collect from its customer users--and remit to the state--the use tax which is merely equal to the sales tax which resident merchants must collect and remit. To excuse Bellas Hess from this obligation is to burden and penalize retailers located in Illinois who must collect the sales tax from their customers. In Illinois the rate is 3.5%, and when it is realized that in some communities the sales tax requires, in effect, that as much as 5% be added to the amount that customers of local, taxpaying stores must pay,18/ the importance of the competitive discrimination becomes apparent. While this advantage to out-of-state sellers is tolerable and a necessary Constitutional consequence where the sales are occasional, minor, and sporadic and not the result of a calculated, systematic exploitation of the market, it certainly should not be extended to instances where the out-of-state company is engaged in exploiting the local market on a regular, systematic, large-scale basis. In such cases, the difference between the nature of the business conducted by the mail order house and by the local enterprise is not entitled to Constitutional significance. The national mail order business amounts to over $2,400,000,000 a year.19/ Some of this is undoubtedly subject to the full range of taxes because of the location of stores in the various states,20/ and some of it is and should be exempt from state use tax because of its sporadic or minor nature. See Report of the Special Subcommittee on State Taxation of Interstate Commerce, of the House Judiciary Committee, H.R. Rep. No. 565, 89th Cong., 1st Sess., [386 US 764] Vol. 3 (1965), at 770-777. But the volume which, under the present decision, will be placed in a favored position and exempted from bearing its fair burden of the collection of state taxes certainly will be substantial, and as state sales taxes increase, this haven of immunity may well increase in size and importance.

In Scripto, supra, this Court applied a sensible, practical conception of the Commerce Clause. The interstate seller which, in that case, claimed Constitutional immunity from the collection of the Florida use tax had, like appellant here, no office or place of business in the state, and had no property or employees there. It solicited orders in Florida through local "independent contractors" or brokers paid on a commission basis. These brokers were furnished catalogues and samples, and forwarded orders to Scripto, out of state. The Court noted that the seller was "charged with no tax--save when...he fails or refuses to collect it" (362 US, at 211 4 L ed 2d at 664)21/ and that the state "reimbursed[ed the seller]...for its service" as tax collector (362 US, at 212, 4 L ed 2d at 664). The same is true in the present case.22/ I do not see how Scripto is [386 US 765] meaningfully distinguishable from this case. In fact, Scripto involved the sale of a single article of commerce. The "exploitation" of the state's market was by no means as pervasive or comprehensive as it here involved, nor was there any reference to the company's use of the state's credit institutions.

The present case is, of course, not at all controlled by Miller Bros. Co. v. Maryland, 347 US 340, 98 L ed 744, 74 S Ct 535 (1954). In that case, as this Court said, the company sold its merchandise at its store in Delaware; there was "no solicitation other than the incidental effects of general advertising...no invasion or exploitation of the consumer market...." 347 US, at 347, 98 L ed at 749. As the Court noted in Scripto, supra, Miller Bros. was a case in which there was "no regular, systematic displaying of its products by catalogs, samples or the like." 362 US, at 212, 4 L ed 2d at 664. On contrary, in the present case, appellant regularly sends not only its catalogue, but even bulk mailings soliciting business addressed to "occupant," and it offers and extends credit to residents of Illinois based on their local financial references.

As the Court says, the test whether an out-of-state business must comply with a state levy is variously formulated: "whether the state has given anything for which it can ask return;"23/ whether the out-of-state business enjoys the protection or benefits of the state;24/ whether there is a sufficient nexus; "some definite link, some minimum connection, between a state and the person, property, or transaction it seeks to tax."25/ However this is formulated, it seems to me entirely clear that a mail order house engaged in the business of regularly, systematically, and on a large scale offering merchandise for sale in a state in competition with local retailers, and [386 US 766] soliciting deferred-payment credit accounts from the state's residents, is not excused from compliance with the state's use tax obligations by the Commerce Clause or the Due Process Clause of the Constitution.

It is hardly worth remarking that appellant's expressions of consternation and alarm at the burden which the mechanics of compliance with use tax obligations would place upon it and others similarly situated should not give us pause. The burden is no greater than that placed upon local retailers by comparable sales tax obligations; and the Court's response that these administrative and recordkeeping requirements could "entangle" appellant's interstate business in a welter of complicated obligations vastly underestimates the skill of contemporary man and his machines. There is no doubt that the collect of taxes from consumers is a burden; but it is no more of a burden on a mail order house such as appellant located in another state than on an enterprise in the same state which accepts orders by mail; and it is, indeed hardly more of a burden than it is on any ordinary retail store in the taxing state.

I would affirm.

NOTES

1/ 34 Ill 2d 164, 214 NE2d 755.

2/ 385 US 809, 17 L ed 2d 50, 87 S Ct 58.

3/ 34 Ill 2d, at 166-167, 214 NE2d, at 757.

4/ Ill Rev Stat c 120, § 439.3 (1965).

5/ Ibid., § 439.5.

6/ Ibid., § 439.11.

7/ Ibid., § 439.14.

8/ Ibid., § 439.12a.

9/ Strictly speaking, there is no question of the connection or link between the state and "the person...it seeks to tax." For that person in Miller Bros. Co. v. Maryland, 347 US 340, 98 L ed 744, 74 S Ct 535, in Scripto Inc. v. Carson, 362 US 207, 4 L ed 2d 660, 80 S Ct 619, and in the present case is the user of the goods to whom the out-of-state retailer sells. National is not the person being directly taxed, but rather it is asked to collect the tax from the user. It is, however, made directly liable for the payment of the tax whether collected or not. Ill Rev Stat c 120, § 439.8 (1965).

10/ National acknowledges its obligation to collect a use tax in Alabama, Kansas, and Mississippi, since it has retail outlets in those states.

11/ As of 1965, 11 states besides Illinois had use tax statutes which required a seller like National to participate in the tax collection system. However, state taxing administrators appear to have generally considered an advertising nexus insufficient. For they have testified that doubts as to the Constitutionality of such statutes underlay their failure to take full advantage of their statutory authority. Report of the Special Subcommittee on State Taxation of Interstate Commerce of the House Committee on the Judiciary, H.R. Rep. No. 565, 89th Cong., 1st Sess., 631-635 (1965). These doubts were substantiated by the only other state supreme court that has considered the issue now before us. The Alabama Supreme Court, dealing with a situation very much like the present one, found that this application of the use tax statute would be invalid under the federal Constitution. State v. Lane Bryant, Inc., 277 Ala 385, 171 So 2d 91.

12/ "Local sales taxes are imposed today [1965] by over 2,300 localities ....In most states, the local sales tax is complemented by a use tax." H.R. Rep. No. 565, supra, at 872.

13/ In 1964, there were seven different rates of sales and use taxes: 2, 2.25, 2.5, 3, 3.5, 4, and 5%. H.R. Rep. No. 565, supra, at 611-13, 607-08. The State of Washington has recently added an eighth, 4.2%. Wash Rev Code § 82.12.020 (Supp 1965).

14/ "The prevailing system requires [the seller] to administer rules which differ from one state to another and whose application--especially for the industrial retailer--turns on facts which are often too remote and uncertain for the level of accuracy demanded by the prescribed system." H.R. Rep. No. 565, supra, at 673.

"Given the broad spread of sales of even small and moderate sized companies, it is clear that if just the localities which now impose the tax were to realize anything like their potential of out-of-state registrants the recordkeeping task of multistate sellers would be clearly intolerable." Ibid., at 882.

15/ Congress has in fact recently evidenced an active interest in this area. See Tit II, PL 86-272, 73 Stat 556, as amended by PL 87-17, 75 Stat 41, which authorized the detailed congressional study of state taxation of interstate commerce that resulted in H.R. Rep. No. 565, supra. See also H.R. Rep. No. 2013, 89th Cong., 2d Sess. (1966).

16/ Moody's Industrial Manual (1962).

17/ Because this case was tried on affidavits, reference has also been made to the National Bellas Hess Catalogue, Spring and Summer 1967, to supplement the picture of appellant's business afforded by the record.

18/ This is the current rate in Pennsylvania. Pa Stat Ann, Tit 72, § 3403-201 (1964). See The World Almanac (1967, Newspaper Enterprise Assn.) 136-137.

19/ U.S. Bureau of the Census, 1963 Census of Business, Retail Trade-Area Statistics, pt 1, table 2, p. 1-8 (1966).

20/ See Nelson v. Sears, Roebuck & Co., 312 US 359, 85 L ed 888, 61 S Ct 586, 132 ALR 475 (1941); Nelson v. Montgomery Ward, 312 US 373, 85 L ed 897, 61 S Ct 593 (1941).

21/ Our observation in Nelson v. Sears, Roebuck & Co., 312 US 359, 365-366, 85 L ed 888, 892, 893, 61 S Ct 586, 132 ALR 475 (1941), is an apt response to appellant's claim that it will not be able to collect all of the tax from its purchasers: "[S]o far as assumed losses on tax collections are concerned, respondent is in no position to found a Constitutional right on the practical opportunities for tax avoidance which its method of doing business affords Iowa residents, or to claim a Constitutional immunity because it may elect to deliver the goods before the tax is paid." Actually, it appears that appellant's method of doing business is such as to minimize the noncollection of the tax.

22/ The Illinois statute provides for a "discount of 2% or $5 per calendar year, whichever is greater...to reimburse the retailer for expenses incurred in collecting the tax, keeping records, preparing and filing returns, remitting the tax and supplying data...." Ill Rev Stat c 120, § 439.9 (1965). Appellant does not claim that this amount is inadequate to reimburse it for its expenses in collecting the tax for the state.

23/ Wisconsin v. J.C. Penney Co., 311 US 435, 444, 85 L ed 267, 270, 61 S Ct 246, 130 ALR 1229 (1940).

24/ Nelson v. Sears, Roebuck & Co., 312 US 359, 364, 85 L ed 888, 892, 61 S Ct 586, 132 ALR 475 (1941).

25/ Miller Bros. Co. v. Maryland, 347 US 340, 344-345, 98 L ed 744, 748, 74 L ed 535 (1954).

Appendix E

U.S. Senate Bill 2811

TO PROVIDE A SIMPLIFIED AND UNIFORM PROCEDURE FOR THE IMPOSITION, COLLECTION, AND ADMINISTRATION OF STATE AND LOCAL SALES AND USE TAXES WITH RESPECT TO INTERSTATE COMMERCE,....

In the Senate of the United States on December 13, 1973, Mr. Mondale introduced the following bill: which was read twice and referred to the Committee on Finance.

A Bill

To provide a simplified and uniform procedure for the imposition, collection, and administration of state and local sales and use taxes with respect to interstate commerce, to reduce significantly the burden of tax compliance for persons engaged in making sales in interstate commerce, and to eliminate restrictions on the taxing power of the states which now prevent them from securing collection and remittance of such taxes on certain interstate sales.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled. That this act may be cited as the "State Taxation of Interstate Commerce Act."

Title I--Taxing Power

Sec. 101. Power of a State to Tax.

a) In General--Each state shall have power to require persons subject to a uniform state and local tax (as defined in Section 303) to collect and remit that tax on sales made by that person within that state.

b) Limitations--No state or political subdivision of a state may impose a sales tax or a use tax other than a uniform state and local tax described in Section 303 imposed and administered in accordance with the provisions of this Act with respect to the sale within that state or political subdivision of tangible personal property by a person who:

1) does not have a business location in that state; or
2) does not regularly make household deliveries in that state (other than by common carrier or the United States Postal Service).

Sec. 102. Voluntary Submission to Tax.

Notwithstanding the provisions of Section 101, a person who does not have a business location in a state or political subdivision of that state, or who does not regularly make household deliveries in that state or political subdivision, may elect to become subject to the sales and use tax laws of that state or political subdivision in lieu of being subject to the uniform state and local tax

imposed by that state. A state or political subdivision of a state may require such a person to collect and remit the sales or use tax imposed by that state or political subdivision (instead of the uniform state and local tax imposed by that state), but no state or political subdivision may require any person to make such an election as a condition of doing business in that state or political subdivision.

Sec. 103. Application of Tax.

A tax imposed by a state or political subdivision of a state in accordance with the provisions of this act may apply to sales the destination of which is in that state or political subdivision without regard to the location of the place at which, or the method by which that sales was solicited, the location of the place at which the order for the sale was accepted, the location of the place from which the property which is the subject of the sales was shipped or the method by which the property was shipped.

Sec. 104. Savings Provision for Certain Methods of Collection.

Nothing in this act prohibits any state or a political subdivision of a state from requiring an advance payment of a sale or use tax to a seller as agent for a state or political subdivision by a purchaser of tangible personal property for resale and nothing in this act prevents a state or a political subdivision of a state from requiring a seller to collect and remit such advance payments as an agent for the state or political subdivision if credit for the advance payment is allowed in determining sales tax liability of the purchaser under statutory provisions in effect in that state or political subdivision on December 31, 1973.

Title II--Rules for Application of Taxes

Sec. 201. Reduction of Multiple Taxation.

a) Taxation of Out-of-State Sales--No state or political subdivision of a state may impose a sale or use tax or a uniform state and local tax with respect to the sale of tangible personal property unless the destination of the sale is:

1) in that state; or
2) in a state or political subdivision of a state for which the tax is required to be collected under a reciprocal collection agreement authorized under Section 405.

b) Credit for Taxes Paid--No state or political subdivision of a state may impose a sales tax, use tax or uniform state and local tax with respect to the sale of tangible personal property on which such a tax, imposed by another state or a political subdivision of that other state, has been paid unless the state or political subdivision imposing the tax allows a credit against its tax for the amount of the tax paid with respect to the property to the other state or political subdivision. For purposes of determining the credit allowable under a tax imposed in accordance with the provision of the preceding sentence:

1) a state is not required to permit a credit against a tax imposed by it for any tax imposed by a political subdivision of another

state; and

2) a political subdivision of a state is not required to permit a credit against a tax imposed by it for any tax imposed by another state.

c) Refund of Taxes--No state or political subdivision of a state may impose a sales tax, use tax or uniform state and local tax with respect to the sale of tangible personal property unless that state or political subdivision provides for the payment of a refund of that tax if such a tax is paid subsequently to another state or political subdivision with respect to that property on account of a liability for the payment of the tax which arose before the liability for the payment of the tax to that state or political subdivision arose. The amount of the refund payable by the state or political subdivision under a tax imposed in accordance with the provisions of the preceding sentence:

1) shall not, in the case of a state government, exceed the amount of the tax imposed by the government of another state; and
2) shall not, in the case of a political subdivision of a state, exceed the amount of the tax imposed by the political subdivision of another state which imposed the tax.

No state or political subdivision shall be required under this subsection to pay a refund of tax if the application for that refund is filed with that state or political subdivision more than one year after the date on which the tax on which the refund is based was paid.

d) Limitation on Credit or Refund for Taxes Paid--No state or political subdivision of a state shall be required to allow a credit under subsection (b) or to pay a refund under subsection (c) with respect to a tax imposed by another state or political subdivision of another state if that tax was measured by periodic payments made under a lease prior to the sale, possession, storage, use, or other consumption of the property with respect to which the tax is imposed in that state or political subdivision imposing the tax. Nothing contained in this act shall be construed to extend the period within which a refund of tax may be made under the laws of any state or political subdivision of a state.

e) Vehicles and Fuels--Nothing in subsection (a) shall be construed to affect the power of a state or a political subdivision of a state to impose or require the collection of a sales or use tax with respect to motor vehicles registered in that state. Nothing in this section shall be construed to affect the power of a state or political subdivision of a state to impose or require the collection of a sales or use tax with respect to motor vehicle fuels sold or consumed in that state.

Section 202. Transportation Charges.

No state or political subdivision of a state shall have power to impose a sales tax, use tax, or uniform state and local tax under which freight charges or other charges for transporting the tangible personal property to which the tax relates are used in determining the tax payable with respect to the sale or use of that property if the freight charges or other charges are separately stated in writing by the seller to the purchaser, and if such charges do not exceed a reasonable charge for transportation by facilities of the seller or

the charge for transportation by the carrier when the transportation is by other than the seller's facilities.

Section 203. Exempt Sales.

a) In General--No state or political subdivision of a state shall have power to impose a sales tax, use tax, or uniform state and local tax unless the law under which that tax is imposed provides for the exemption from tax of sales described in subsections (b), (c), (d), (e) and (f) in accordance with the provisions of those subsections.

b) Sales for Resale--No Seller shall be liable for the collection or payment of a sales tax, use tax, or uniform state and local tax with respect to an interstate sale of tangible personal property if the purchaser of such property furnishes or has furnished to the seller a certificate or other written form of evidence attesting to the fact that the property is being purchased for resale. Any such certificate or other written form of evidence shall give the name and address of the purchaser, his registration number, the citation for the exemption under the respective state and political subdivision law, and shall be signed by the purchaser or his representative. Nothing in this subsection shall relieve a seller of the liability for collecting and remitting an advance payment of a sales or use tax required to be made by a purchaser for which the purchaser will receive a credit in determining liability of the purchaser under statutory provisions in effect on December 31, 1973.

c) Sales to the United States Government--No state or political subdivision thereof may impose a sales or use tax on tangible personal property sold directly to the United States Government and no seller shall be required to collect or remit a sales or use tax on such sales.

d) Sales for Transshipment--No seller shall be liable for the collection or payment of a sales or use tax with respect to an interstate sale of tangible personal property if the purchaser furnishes or has furnished to the seller a statement in writing that the property will be transshipped from the destination within the United States to a point outside the United States for use or consumption outside the United States. Nothing in this subsection shall prevent the imposition of a sales or use tax by a state or political subdivision on property initially covered by this exemption upon its subsequent return to a state or political subdivision for use or consumption.

e) Elective Exemptions--No seller shall be liable for the collection or payment of a sales or use tax with respect to an interstate sale of tangible personal property if the purchaser of such property furnishes or has furnished to the seller:

1) a registration number or other form of identification indicating that the purchaser is registered with the state or the political subdivision thereof imposing the sales or use tax which is the destination at which the property will be delivered to the purchaser; and
2) a certificate from the state or political subdivision having jurisdiction to require seller collection of the tax setting forth a legal citation under the laws of that state or political subdivi-

sion which specifically exempts the property or transaction from the tax imposed by that state or political subdivision.

f) Retention of Certificates--Any certificate required under subsections (b) through (e) shall be retained by the seller and made available by him to any taxing authority for inspection for 36 months after the date of the sale to which it relates. No sale shall be treated as a sale described in any of those subsections unless the seller can make the certificate relating to that sale available to the taxing authority requesting inspection of it during that 36-month period.

Sec. 204. Accounting Requirements.

Any state which imposes a uniform state and local tax in accordance with the provisions of this act may require any person engaged in the business of selling property to which that tax applies to collect that tax and remit it to the state and to maintain such records and information as may be necessary for the proper administration of that tax, but no state shall have power to require that person to account for sales on the basis of any geographic or political subdivision of the state.

Title III--Definitions and Rules

Sec. 301. Sales Tax.

The term "sales tax" means any tax imposed with respect to retail sales, and measured by the sales price of tangible personal property or services with respect thereto, which is required by state law to be stated separately from the sale price by the seller, or which is customarily stated separately from the sales price.

Sec. 302. Use Tax.

The term "use tax" means a tax imposed only once with respect to the exercise or enjoyment of any right of ownership or use of, or of any power over, tangible personal property incident to the ownership or possession of that property under lease or otherwise (including the consumption, holding, retention, or other use of that property) which is measured by the purchase price or value of the property.

Sec. 303. Uniform State and Local Tax.

a) In General--The term "uniform state and local tax" means a sales or use tax, or a combined sales and use tax, certified to the Secretary of Commerce of the United States by the chief executive officer of a state as the single sales, use, or combined sales and use tax imposed by that state on:

1) sales with a destination in that state of tangible personal property by a person who does not maintain a place of business in the state or make regular household deliveries in the state; or
2) the use of tangible personal property in that state acquired by purchase, by a resident of that state, from such a person.

b) Rate of Tax--

1) Sales Tax--If the uniform state and local tax is a sales tax, it shall be a percentage of the amount of any sale to which it applies. That percentage shall not exceed the sum of:

   A) the percentage rate applicable under any sales tax imposed by the government of the state to sales of such property sold within the state by residents of that state; and
   B) a percentage rate equal to a fraction, the numerator of which is the sum of the revenues of each political subdivision within that state from sales taxes imposed by such political subdivisions on sales of such property during the most recent fiscal year for which data is available (adjusted for any change in the rate of such sales taxes), and the denominator of which is the sum of the amounts of the sales to which such sales taxes applied.

2) Use Tax--If the uniform state and local tax is a use tax, it shall be a percentage of the value of the property to which it applies. That percentage shall not exceed the sum of:

   A) the percentage rate applicable under any use tax imposed by the government of the state on the use of such property by residents of that state which is acquired by purchase from other residents of that state; and
   B) a percentage rate equal to a fraction, the numerator of which is the sum of the revenues of each political subdivision within that state from use taxes imposed by such political subdivisions on the use of such property for the most recent fiscal year for which data is available (adjusted for any change in the rate of such use taxes), and the denominator of which is the sum of the values of the property to which such use taxes applied.

3) Combined Sales and Use Tax--If the uniform state and local tax is a combined sales and use tax, the sales tax portion shall be determined under paragraph (1) and the use tax portion shall be determined under paragraph (2).

Sec. 304. Sale, Sales Prices, Purchase Price.

The terms "sale," "sales price," and "purchase price" include (but are not limited meaning to) amounts paid under leases and rental payments for the use of property and amounts paid for services which are defined as taxable services under the laws of a state or political subdivision thereof.

Sec. 305. Interstate Sale.

The term "interstate sale" means a sale in which tangible personal property sold is shipped or delivered to the purchaser in a state from a point outside that state.

Sec. 306. Destination.

The term "destination of a sale" means the state or political subdivision in which possession of the property is physically transferred to the purchaser or to which the property is shipped to the purchaser regardless of the free on board point or other conditions of the sale.

Sec. 307. Business Location.

A person shall not be considered to have a business location within a state or political subdivision unless he:

1) owns or leases real property within that state or political subdivision;
2) has an employee located within that state or political subdivision;
3) regularly maintains a stock of tangible personal property in that state or political subdivision for sale in the ordinary course of his business; or
4) is engaged in the business of leasing tangible personal property to other persons for use in that state or political subdivision.

For purposes of paragraph (3), property held by a consignee under consignment and offered for sale by him on his own account shall not be considered as stock maintained by the consignor, and property held by a purchaser under a sale or return arrangement shall not be considered a stock maintained by the person who furnished the stock to the purchaser under that arrangement. If a person has a business location in a state or a political subdivision solely on account of paragraph (4), he shall be considered to have a business location in that state or political subdivision only with respect to such property.

Sec. 308. Location of Employee.

a) In General--An employer shall be considered to have any employee located within a state or political subdivision if the employee's service for the employer is performed entirely or primarily in that state or political subdivision. An employer shall not be considered to have an employee located in a state or political subdivision if the employee's activities on behalf of his employer within that state or political subdivision consists entirely of:

1) the solicitation of orders for sales of tangible personal property which are sent outside the state or political subdivision for approval and which are filled by shipment or delivery from outside that state or political subdivision; or
2) the solicitation of orders in the names of, or for the benefit of, a prospective customer of the employer if those orders are orders described in paragraph (1).

b) Employees of Contractors and Extractors--If the employer is engaged in the performance of a contract for the construction of improvements on, or to real property in a state or political subdivision or of a contract for the extraction of natural resources located in a state or political subdivision, an employee whose services are related primarily to the performance of the contract shall be considered to be located in that state or political subdivision. This subsection shall not apply with respect to services performed in installing or repairing tangible personal property which is the subject of interstate sale by the employer, if such installing or repairing is incidental to the sale.

c) The term "employee" has the same meaning as it has for purposes of federal income tax withholding under Chapter 24 of the Internal Revenue Code of 1954.

Sec. 309. State.

The term "state" means the several states of the United States and the District of Columbia.

Sec. 310. State Law.

References in this act to "state law" and "laws of the state," include the constitution, statutes and other legislative acts, judicial decisions, and administrative regulations and rulings of a state and of any political subdivision.

Title IV--Miscellaneous Provisions

Sec. 401. Prohibition Against Discrimination Based on Out-of-State Occurrences.

No state or political subdivision of a state may impose a sales tax, use tax, or uniform state and local tax under which a person liable for the payment or collection of that tax is liable for the payment or collection of a higher rate of tax than any other person subject to that sales, use, or uniform state and local tax because:

1) he is incorporated or qualified to do business in another state or political subdivision, or because he engages in any activity in another state or political subdivision;
2) he is taxable under the laws of another state or political subdivision of that state; or
3) other persons (including any agency of a state or political subdivision of a state) are engaged in activities in another state or political subdivision of that state which affect him.

The application of a uniform state and local tax to a person at a higher rate of tax than the combined state and local sales or use tax might otherwise be applicable to such person (if he made an election under Section 102) is not a violation of the provisions of the preceding sentence.

Sec. 402. Permissible Audits.

a) Audits by State and Political Subdivisions--Any state or political subdivision of a state which imposes a sales tax or use tax (but not a uniform state and local tax) shall have power, independently or in combination with any other state or political subdivision or group of states or political subdivisions, to conduct audits of the records of any person who is liable for the payment or collection of that tax.

b) Audits by State Only--If any state imposes a uniform state and local tax, only the state shall have the power, independently or in combination with any other state or group of states who have also imposed such a tax, to conduct audits of the records of any person who is liable for the payment or collection of that tax.

Sec. 403. Limitation on Audits.

No state or political subdivision shall conduct an audit in combination with any other state or political subdivision of a state unless it certifies to the person subject to the audit that any information obtained as a result of the audit will remain confidential between parties to the joint audit and will be used to establish tax liability with respect to the period covered by the audit only. If a state or political subdivision of a state audits a person in accordance with the provisions of this section it may not subsequently conduct an audit of that person for a prior taxable period, unless the person and the state or political subdivision shall have previously entered into an agreement, binding upon both parties under the laws of the state or political subdivision, under which liability for such prior period may be determined. The preceding sentence does not apply to any audit of such a prior taxable period if the state or political subdivision is permitted, under Section 406(b), to make an assessment with respect to that period.

Section 404. Prohibition Against Audit Charges.

No charge may be imposed upon a person audited by a state or political subdivision thereof to cover any part of the cost of conducting that audit outside that state or political subdivision, respectively.

Sec. 405. Reciprocal Collection Agreements.

The Congress hereby gives its consent to agreements between and among states under which one state will undertake to collect a sales tax, use tax, or uniform state and local tax imposed by another state whenever the person liable for the payment or collection of such tax has a business location in the state which undertakes the collection but not in the state which imposes the tax, but such agreements shall not provide for the collection of tax with respect to a sale or use of tangible personal property which is not taxable under the laws of the state which imposes the tax.

Sec. 406. Liability with Respect to Unassessed Taxes.

a) Limitation on Assessment Period--Except as provided in subsection (b), no state or political subdivision thereof shall have the power, after the date of enactment of this act, to assess against any person for any period ending on or before such date a sales or use tax with respect to tangible personal property, if during such period that person:

1) was not registered in the state or political subdivision for the purpose of collecting tax;
2) had no business location in the state or political subdivision;
3) did not regularly engage in the household delivery of property in the state or political subdivision (other than by common carrier or United States Postal Service); or
4) did not regularly solicit orders for the sale of tangible personal property by salesmen, solicitors, or other representatives in the state or political subdivision.

b) Extension Where Required by Law--A state or political subdivision may

make an assessment covering a period prior to enactment of this act if the state or political subdivision and the person subject to the tax where legally bound by agreement contract decision of any court having jurisdiction or statutory or Constitutional provision to determine liability after enactment of this act.

Title V--Administrative Provisions

Sec. 501. Return Forms.

a) In General--

1) Sales or Use Tax Returns--A state or a political subdivision of a state may require the filing of returns by persons liable for the payment of any sales tax or use tax imposed by that state or political subdivision (other than a uniform state and local tax).

2) Uniform State and Local Tax Returns--A state which imposes a uniform state and local tax applicable only to persons who do not have a business location within that state or who do not regularly make parcel deliveries in that state, may not require such a person to file a return containing information other than:

A) the name and address of such person;
B) the federal employer identification number of such person;
C) the type of report;
D) the period covered by the report;
E) the gross sales of that person within the state or political subdivision;
F) the total amount of sales by that person within the state which are exempt from such tax;
G) the sales of such person within that state or political subdivision which are subject to tax; and
H) the liability of that person for the payment or collection of tax.

3) Standard Form--The Secretary of Commerce shall make available to the states a standard form for the return of the uniform state and local tax which shall be used by any state which imposes such a tax.

4) Time for Filing--A state or political subdivision of that state may require returns described in paragraph (2) to be filed with it no later than 30 days after the end of each calendar quarter with respect to taxes for that quarter but shall permit any taxpayer required to file such a return to elect at such time and in such manner as that state or political subdivision may by law prescribe to file such return not later than the last day of each month with respect to taxes for the preceding month.

b) Annual Summary--Any person liable for the payment or collection of any tax to which this act applies shall file annually with his federal income tax return a schedule showing gross receipts from the sale of tangible personal property within each state. The Secretary of the Treasury shall provide the infor-

mation shown on such schedules to the appropriate officers within each state engaged in the administration of the tax laws of that state. Failure to file such a schedule is punishable by a fine of not to exceed $1,000, imprisonment for one year, or both.

Sec. 502. Exemption for Minimum Sales of Tangible Personal Property in Interstate Commerce.

No state or political subdivision of a state shall have power to impose a uniform state and local tax on the sale of tangible personal property within that state or political subdivision as the case may be with respect to any person who does not sell tangible personal property for a price in the aggregate in excess of $10,000 within that state during the calendar year.

Title VI--Remedy, Effective Date

Sec. 601. Remedy.

Any person who is liable for the payment of a tax imposed by a state or political subdivision with respect to the sale of tangible personal property within that state may notwithstanding any other provision of law, bring an action in any district court of the United States for a district located within that state for a declaratory judgment with respect to whether the law under which that tax is imposed meets the requirements of this act.

Sec. 602. Effective Date.

Except as provided in Sections 403 and 406, this act shall apply to the sale or use of a tangible personal property occurring after January 1, 1976.

Sec. 603. Nonseparability.

It is the intention of the Congress in enacting this act to provide a single integrated statutory framework for the state taxation of interstate commerce. If any provision of this act, or the application thereof to any person or circumstance is held invalid under the Constitution by any court of the United States, then if such holding is not appealed, the remainder of this act shall cease to be effective on the day after the last date on which an appeal could have been timely filed with respect to such holding.

U.S. Senate Bill 983

TO REGULATE AND FOSTER COMMERCE AMONG THE STATES BY PROVIDING A SYSTEM FOR THE TAXATION OF INTERSTATE COMMERCE

April 23 (legislative day, April 9) 1979

Mr. Mathias introduced the following bill; which was read twice and referred to the Committee on Finance.

A Bill

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, that this act may be cited as the "Interstate Taxation Act of 1979."

Title I--Sales and Use Taxes

Part A--Jurisdiction and Administration

Sec. 101. Uniform Jurisdictional Standards.

a) State Standard--No state shall have power to require a person to collect a sales or use tax with respect to a sale or use of tangible personal property unless that person:

1) has a business location in that state;
2) regularly solicits orders for the sale of tangible personal property by means of salesmen, solicitors, or representatives in that state, unless his activity in that state consists solely of solicitation by direct mail or advertising by means of printed periodicals, radio, or television; or
3) regularly engages in the delivery of tangible personal property in that state other than by common carrier or United State Postal Service.

b) Political Subdivision Standard--No Political subdivision of a state shall have power to require a person to collect a sales or use tax with respect to a sale or use of tangible personal property unless that person:

1) has a business location in that political subdivision;
2) regularly solicits orders for the sale of tangible personal property by means of salesmen, solicitors, or representatives in that political subdivision, unless his activity in that political subdivision consists solely of solicitation by direct mail or advertising by means of printed periodicals, radio, or television; or
3) regularly engages in the delivery of tangible personal property in that political subdivision other than by common carrier or United States Postal Service.

c) Freight Charges Incident to Interstate Sales--Where the freight and other charges for transporting tangible personal property to a purchaser incident to an interstate sale are not included in the purchase price but are stated separately by the seller, no state or political subdivision thereof shall have

power to include such charges in the measure of a sales or use tax imposed with respect to the sale or use of such property.

Sec. 102. Reduction of Multiple Taxation.

a) Destination in State; Cooperative Agreements Between States--A state may impose a sales tax or require a seller to collect a sales or use tax with respect to an interstate sale of tangible personal property only if the destination of the sales is:

1) in that state; or
2) in a state or political subdivision for which the tax is required to be collected by an agreement between the state of destination and the state requiring such collection, and the seller has a business location in the state requiring such collection.

b) Destination in Political Subdivision--A political subdivision of a state may impose a sales tax or require a seller to collect a sales or use tax with respect to an interstate sale of tangible personal property only if the destination of the sale is in that political subdivision.

c) Limitation--Notwithstanding Section 101 and subsections (a) and (b) of this section, no state or political subdivision thereof shall have power to require an out-of-state seller to collect a sales or use tax with respect to an interstate sale of tangible personal property with a destination in that state if such seller's annual receipts from taxable retail sales of tangible personal property with a destination in that state are less than $20,000, except that this limitation shall not be effective to the extent that such seller has, in fact, collected a separately stated sales or use tax from the purchaser. In determining whether the foregoing limitation applies, an out-of-state seller shall be deemed to have less than $20,000 in annual receipts from taxable retail sales of tangible personal property with a destination in a state if such seller's receipts from such sales during the preceding calendar year did not exceed $20,000.

d) Credit for Prior Taxes--The amount of any use tax imposed by a state or political subdivision thereof with respect to tangible personal property shall be reduced by the amount of any sales or use tax previously paid by the taxpayer with respect to the same property on account of liability to another state or political subdivision thereof.

e) Refunds--A person who pays a use tax imposed with respect to tangible personal property shall be entitled to a refund from the state or political subdivison thereof imposing the tax, up to the amount of the tax so paid, for any sales or use tax subsequently paid to the seller with respect to the same property on account of prior liability to another state or political subdivision thereof.

f) Vehicles, Boats, and Motor Fuels--

1) Vehicles and Boats--Nothing in subsection (a) or (b) shall affect the power of a state or political subdivision thereof to impose or require the collection of a sales or use tax with respect to

motor vehicles and boats registered in that state.

2) Fuels--Nothing in this section shall affect the power of a state or political subdivision thereof to impose or require the collection of a sales or use tax with respect to motor fuels consumed in that state.

Sec. 103. Sales to Registered Business Purchase; Exempt Sales Certifies as Such by Purchaser.

No seller shall be liable for the collection or payment of a sales or use tax with respect to an interstate sale of tangible personal property if the purchaser of such property furnishes or has furnished to the seller:

1) a statement indicating that the purchaser is registered with the jurisdiction imposing the tax to collect or pay such tax; or
2) a certificate or other form of evidence indicating the basis for exemption or other reason the seller is not required to collect or pay such tax.

Any statement, certificate, or other form of evidence furnished for purpose of paragraph (1) or (2) shall be in writing, shall give the name and address of the purchaser and his registration number, if any, and shall be signed by the purchaser or his representative. Nothing in this section shall limit the liability of a seller who, at the time of receipt of a statement, certificate, or other form of evidence furnished by a purchaser for purposes of paragraph (1) or (2), has actual knowledge that such document is false or inaccurate.

Sec. 104. Sales by Certain Out-Of-State Sellers.

a) Election to Collect Tax Certified by Purchaser--With respect to any calendar year, an out-of-state seller who has less than $100,000 annually in taxable sales of tangible personable property with a destination in a state may, in lieu of collecting any sales or use tax which that state or a political subdivision thereof may require to be collected under Sections 101 and 102, elect to collect and remit to that state a combined state and local sales or use tax at a rate or in an amount which shall be certified to such seller by the purchaser as being the correct rate or amount applicable to the sale. Any such certification shall be in writing, shall give the name and address of the purchaser and his registration number, if any, and shall be signed by the purchaser or his representative. Nothing in this section shall limit the liability of an out-of-state seller who has made an election under this subsection and who, at the time of receipt of a purchaser's certification of the correct rate or amount of tax applicable to an interstate sale with a destination in a state to which such election applies, has actual knowledge that such certification is false or inaccurate.

b) Failure of Purchaser to Certify Correct Rate or Amount of Tax--If an election under subsection (a) is in effect with respect to a state, and a purchaser in that state who purchases tangible personal property from the electing out-of-state seller fails or refuses to certify to such seller the correct rate or amount of sales or use tax applicable to the sale, such seller shall collect and remit the highest combined state and local sales or use tax which could be imposed with respect to any interstate sale having a destination in that state

and shall in no way be liable to such purchaser for any excess of the tax so collected over the correct amount of tax applicable to the sale.

c) Determination of Annual Taxable Sales in a State--For purposes of determining whether an out-of-state seller is eligible to make an election under subsection (a) with respect to any calendar year, such seller shall be deemed to have less than $100,000 annually in taxable sales of tangible personal property with a destination in a state if such seller's receipts from such sales during the preceding calendar year did not exceed $100,000.

d) Administration--No state may require an out-of-state seller who elects under subsection (a) to collect combined state and local sales and use taxes pursuant to purchasers' certifications of the correct rates or amounts of such taxes to remit the taxes so collected more frequently than once each calendar quarter. A state may require such a seller to maintain such records, certifications and other information as may be necessary for the proper administration of such taxes, but may not require such a seller to classify or otherwise account for the sales to which such taxes relate according to geographic areas of that state in any manner whatsoever, including classification by political subdivision.

e) Standard Form or Return--The Secretary of Commerce of the United States shall prescribe a standard form of return for the combined state and local sales and use taxes collected by an out-of-state seller who has made an election under subsection (a), and no state or political subdivision thereof may require such seller to file, with respect to such taxes, a form of return other than such standard form. The filing of a certified duplicate copy of such standard form incorporating the information required for all states with respect to which such seller has made an election under subsection (a) shall be accepted in lieu of the filing of a separate return for each such state.

Sec. 105. Accounting for Local Taxes.

No seller shall be required by a state or political subdivision thereof to classify interstate sales for sales or use tax accounting purposes according to geographic areas of that state in any manner other than to account for interstate sales with destinations in political subdivisions in which the seller has a business location or regularly makes household deliveries.

Sec. 106. Savings Provisions.

a) Use Taxes--Nothing in this Act shall prohibit a state or political subdivision thereof from imposing and collecting a use tax from a purchaser or user with respect to use in that state or political subdivision of tangible personal property:

1) acquired in an interstate sale from an out-of-state seller who is not required to collect such a tax with respect to such sale; or
2) acquired outside that state or political subdivision and brought into that state or political subdivision by such purchaser or user.

b) Correct Tax Not Collected--Nothing in this Act shall prohibit a state

or political subdivision thereof from collecting a sales or use tax from a person who purchases tangible personal property in an interstate sale if for any reason, including an incorrect or invalid certification or representation made by such purchaser with respect to the tax-exempt status of such sale or, in the case of a purchase from an out-of-state seller having made an election under Section 104(a), with respect to the correct rate or amount of tax applicable to such sale, the seller has not collected the correct amount of sales or use tax from such purchaser. This subsection shall not apply if the seller has collected the correct amount of tax from the purchaser but has failed to remit such tax to the state.

c) Certain Advance Payments--Nothing in this act shall prohibit a state or political subdivision thereof from requiring a purchaser of tangible personal property for resale to make an advance payment of a sales or use tax to the seller of such property, or from requiring such seller to act as agent for such state or political subdivision and in that capacity to collect and remit such advance payment: Provided, that credit for such advance payment is allowed in determining the sales or use tax liability of the purchaser and provided that all the foregoing requirements are imposed pursuant to laws of such state or political subdivison which were in effect on December 31, 1974.

Sec. 107. Liability with Respect to Unassessed Taxes.

a) Periods Ending Prior to Enactment Date--No state or political subdivision thereof shall have the power, after the date of the enactment of this act, to assess against any person for any period ending on or before such date in or for which that person became liable for the tax involved, a sales or use tax with respect to tangible personal property, unless during such period that person:

1) had a business location in that state;
2) regularly solicited orders for the sale of tangible personal property by means of employees present in that state, unless his activity in that state consisted solely of solicitation by direct mail or advertising by means of printed periodicals, radio or television; or
3) regularly engaged in the delivery of tangible personal property in that state other than by common carrier or United States Postal Service.

b) Certain Prior Assessments and Collections--The provisions of subsection (a) shall not be construed:

1) to invalidate the collection of a tax prior to the time assessment became barred under subsection (a); or
2) to prohibit the collection of a tax at or after the time assessment became barred under subsection (a), if the tax was assessed prior to such time.

Part B--Definition and Rules

Sec. 151. Sales Tax, Sale, Sales Price.

A "sales tax" is any tax imposed with respect to, and measured by the

sales price of, the sale of tangible personal property or services with respect to such a sale, and which tax is required by state law to be stated separately from the sales price by the seller or is customarily stated separately from the sales price. The term "sale" includes any lease or rental of tangible personal property and the term "sales price" includes receipts from any such lease or rental.

Sec. 152. Use Tax.

A "use tax" is any nonrecurring tax, other than a sales tax, which is imposed on, or with respect to the exercise or enjoyment of any right or power over tangible personal property incident to the ownership of that property or the leasing of that property from another, including any consumption, keeping, retention, or other use of tangible personal property.

Sec. 153. Interstate Sale.

An "interstate sale" means a sale in which the tangible personal property sold is shipped or delivered to the purchaser in a state from a point outside that state.

Sec. 154. State.

The term "state" wherever used in this act means the District of Columbia or any of the 50 states of the United States.

Sec. 155. Destination.

The "destination" of a sale is in the state or political subdivision in which possession of the property is physically transferred to the purchaser, or to which the property is shipped to the purchaser regardless of the free on board point or other conditions of the sale.

Sec. 156. Out-of-State Seller.

An "out-of-state seller" with respect to any state is a seller who does not have a business location in that state.

Sec. 157. Business Location.

A person shall be considered to have a "business location" within a state only if that person:

1) owns or leases real property within that state;
2) has one or more employees located in that state; or
3) regularly maintains a stock of tangible personal property in that state for sale in the ordinary course of his business.

For purposes of paragraph (3), property which is on consignment in the hands of a consignee and is offered for sale by such consignee shall not be considered as stock maintained by the consignor, and property which is in the hands of a purchaser under a sale or return arrangement shall not be considered as stock maintained by the seller.

Sec. 158. Location of Property.

Property shall be considered to be located in a state if it is physically present in that state.

Sec. 159. Location of Employee.

a) General Rule--An employee shall be considered to be located in a state if:

1) the service of such employee is localized in that state; or
2) the service of such employee is not localized in any state but some of such service is performed in that state and such employee's base of operations is in that state.

b) Localization of Service--An employee's service shall be considered to be localized in a state if:

1) such service is performed entirely within that state; or
2) such service is performed both within and without the state, but the service performed without that state is incidental to the service performed within that state.

c) Base of Operations--An employee's base of operations is that single place of business, having a permanent location, which is maintained by his employer, and from which he regularly commences his activities and to which he regularly returns in order to perform the functions necessary to the exercise of his trade or profession.

d) Continuation of Minimum Jurisdictional Standard--An employee shall not be considered to be located in a state if his business activities within that state on behalf of his employer are limited to any one or more of the following:

1) The solicitation of orders for sales of tangible personal property, which orders are sent outside that state for approval or rejection and (if approved) are filled by shipment or delivery from a point outside the state.
2) The solicitation of orders for sales of, or for the benefit of a prospective customer of his employer, if orders by such customer to such employer to enable such customers to fill orders resulting from such solicitation are orders described in paragraph (1).
3) The installing or repairing of tangible personal property which is the subject of an interstate sale by the employer, if such installation or repair is incidental to the sale.

This subsection shall not apply with respect to business activities carried on by one or more employees within a state if the employer (without regard to those employees) has a business location in that state.

e) Employees of Contractors and Extractors--If the employer is engaged in the performance of a contract for the construction of improvements on, or to real property in a state or of a contract for the extraction of natural resources located in a state, an employee whose services in that state are re-

lated primarily to the performance of such contract shall be presumed to be located in that state. This subsection shall not apply with respect to services performed in installing or repairing tangible property which is the subject of an interstate sale by the employer, if such installation or repair is incidental to the sale.

f) Employee--No person shall be considered an employee of an employer unless such person is an employee of such employer for purposes of federal income tax withholding under Chapter 24 of the Internal Revenue Code of 1954, as amended.

Sec. 160. Household Deliveries.

A seller makes household deliveries in a state or political subdivision if he delivers goods, otherwise than by common carrier or United States Postal Service, to the dwelling place of his purchasers located in that state or political subdivision.

Sec. 161. Limitation on Applicability.

Except as otherwise expressly provided in this act, the definitions and rules set forth in this part shall apply only for purposes of this title.

Title II--Gross Receipts Taxes

Part A--Jurisdiction

Sec. 201. Uniform Jurisdiction Standard.

No state or political subdivision thereof shall have power to impose a gross receipts tax with respect to the interstate sale of tangible personal property unless the sale is solicited directly through a business office of the seller in the state or political subdivision.

Sec. 202. Savings Provision.

Nothing in this act shall prohibit a state or political subdivision thereof from imposing and collecting a gross receipts tax on activities occurring entirely within that state or political subdivision, including any tax imposed with respect to the extraction of oil, coal, minerals, or other natural resources located within that state or political subdivision.

Part B--Definitions

Sec. 251. Gross Receipts Tax.

For purposes of this title, a "gross receipts tax" is any tax, other than a sales tax, which is imposed on or measured by the gross volume of business (whether in terms of gross receipts or in other terms), which is applicable to commercial or manufacturing business in general, and in the determination of which no deduction is allowed which would constitute the tax a net income tax.

Sec. 252. Business Office.

For purposes of this title, a seller shall be considered to have a "business office" in a state or political subdivision only if that seller:

1) owns or leases real property within the state or political subdivision; or
2) regularly maintains a stock of tangible personal property in that state or political subdivison for sale in the ordinary course of his business.

For purposes of paragraph (1), a seller shall not be considered as owning or leasing real property which is owned or leased by that seller's employee, unless that seller pays the costs of owning or leasing such property. For purposes of paragraph (2), property which is on consignment in the hands of a consignee and is offered for sale by such consignee on his own account shall not be considered as stock maintained by the consignor, and property which is in the hands of a purchaser under a sale or return arrangement shall not be considered as stock maintained by the seller.

Sec. 253. Other Definitions.

For purposes of this title, the terms "sales tax," "state" and "interstate sale" have the same meaning as such terms have for purposes of Title I of this act, and the term "net income tax" has the same meaning as such term has for purposes of Title III of this act.

Title III--Net Income Taxes

Part A--Apportionable and Allocable Income

Sec. 301. Optional Three-Factor Formula.

A state or political subdivision thereof may not impose for any taxable year on a corporation taxable in more than one state, other than an excluded corporation, a net income tax measured by an amount of net income in excess of the amount determined by (1) multiplying the corporation's base by an apportionment fraction which is the average of the corporation's equally weighted property, payroll and sales factors for that state for the taxable year and (2) adding to the amount determined under clause (1) the amount of income allocable to that state for the taxable year. For this purpose, the base to which the apportionment fraction is applied shall be the corporation's apportionable income as defined in this title for that taxable year. No state shall, by reason of not including dividends or foreign source income in apportionable income, make any offsetting adjustment of an otherwise allowable deduction which is unrelated to such excluded dividend or foreign source income.

Sec. 302. Income Allocable to a State; Exclusions from Apportionable and Allocable Income.

Dividends received from corporations in which the taxpaying corporation owns less than 50% of the voting stock, other than dividends which constitute foreign source income, are income allocable to the state of commercial domicile of such taxpaying corporation and are not apportionable or allocable to any other state. No dividends received from corporations in which the taxpaying

corporation owns 50% or more of the voting stock and no foreign source income of such taxpaying corporation shall be apportionable or allocable to any state.

Sec. 303. Combined or Consolidated Reporting.

a) Except as otherwise provided in subsection (b), a state may require, or a corporation may elect, that the taxable income of the corporation be determined by reference to the combined or consolidated net income and the combined or consolidated apportionment factors of all affiliated corporations in the affiliated group of which the corporation is a member.

b) For purposes of subsection (a), no state may require, and no corporation may elect, that a combination or consolidation of an affiliated group include:

1) any excluded corporation; or
2) any corporation, substantially all the income of which is derived from sources without the United States.

For purposes of paragraph (2), substantially all the income of a corporation (whether a domestic or a foreign corporation) shall be deemed to be derived from sources without the United States if 80% or more of its gross income is derived from sources without the United States in the current taxable year and in each of the two preceding taxable years (excluding any period during which such corporation was not in existence).

c) Nothing in this title shall preclude the determination of combined or consolidated income on a basis acceptable to both the state and the taxpaying corporation.

Part B--Definitions and Rules

Sec. 351. Net Income Tax.

A "net income tax" is a tax which is imposed on or measured by net income.

Sec. 352. Excluded Corporation.

An "excluded corporation" is any of the following:

1) Any bank, trust company, savings bank, industrial bank, land bank, safe deposit company, private banker, small loan association, credit union, cooperative bank, small loan company, sales finance company, or investment company, or any type of insurance company, or any corporation which derives 90% or more of its gross income from interest (including discount).
2) Any corporation more than 50% of the ordinary gross income of which for the taxable year is derived from regularly carrying on any one or more of the following business activities:

   A) the transportation for hire of property or passengers, including the rendering by the transporter of services incidental to such transportation;

B) the sale of electrical energy or water; or
C) the furnishing of public telegraph or intrastate telephone services.

Sec. 353. Affiliated Corporations.

Two or more corporations are "affiliated" if they are members of the same group comprised of one or more corporate members connected through stock ownership with a common owner, which may be either corporate or noncorporate, in the following manner:

1) more than 50% of the voting stock of each member other than the common owner is owned directly by one or more of the other members; and
2) more than 50% of the voting stock of at least one of the members other than the common owner is owned directly by the common owner.

Sec. 354. Apportionable Income.

Except to the extent otherwise provided in Section 301 or Section 302, the "apportionable income" of a corporation means its net income subject to apportionment as determined under the laws of the taxing state.

Sec. 355. Property Factor.

a) In General--A corporation's property factor for any state is a fraction, the numerator of which is the average value of the corporation's real and tangible personal property owned and used or rented and used during the taxable year and located in that state and the denominator of which is the average value of all corporation's real and tangible personal property owned and used or rented and used during the taxable year and located everywhere, except that such denominator shall not include any property which the state or the corporation determines to exclude pursuant to Section 358(c).

b) Standards for Valuing Property in Property Factor--

1) Owned Property--Property owned by the corporation shall be valued at its original cost.
2) Rented Property--Property rented to the corporation shall be valued at eight times the net rents payable by the corporation during the taxable year. Net rent is the gross rent payable by the corporation less rent received by the corporation from subrentals.

Sec. 356. Payroll Factor.

a) In General--A corporation's payroll factor for a state is a fraction, the numerator of which is the amount of wages paid or accrued during the taxable year by the corporation to employees located in that state and the denominator of which is the total amount of wages paid or accrued during the taxable year by the corporation to all employees located everywhere, except that such denominator shall not include any wages which the state or the corporation determines to exclude pursuant to Section 358(c).

b) Definition of Wages--The term "wages" means wages as defined for purposes of the Federal Unemployment Tax Act in Section 3306(b) of the Internal Revenue Code of 1954, as amended, determined without regard to the limitation of Section 3306(b)(1) on the amount of wages.

Sec. 357. Sales Factor.

a) In General--A corporation's sales factor for a state is a fraction, the numerator of which is the total sales of the corporation in that state during the taxable year and the denominator of which is the total sales of the corporation everywhere during the taxable year, except that such denominator shall not include any sales which the state or the corporation determines to exclude pursuant to Section 358(c).

b) Sales Included--

1) Sales of tangible personal property are in a state if such property is received in that state by the purchaser. In the case of delivery by common carrier or by other means of transportation, the place at which such property is ultimately received after all transportation has been completed shall be considered as the place at which such property is received by the purchaser. Direct delivery in a state, other than for purposes of transportation, to a person or firm designated by a purchaser constitutes delivery to the purchaser in that state and direct delivery outside a state to a person or firm designated by a purchaser does not constitute delivery to the purchaser in that state, regardless of where title passes or other conditions of sale.
2) Sales, other than sales of tangible property, are in a state if:

A) the income-producing activity is performed in that state; or
B) the income-producing activity is performed both in and outside that state and a greater proportion of the income-producing activity is performed in that state than in any other state, based on costs of performance.

c) Location of Certain Other Sales--

1) Sales of services shall be included in the numerator of the sales factor for the state in which the service is performed. Sales of services rendered in two or more states shall, for the purpose of the numerator of the sales factor, be divided between those states in proportion to the direct costs of performance incurred in each such state by the corporation in rendering the services.
2) Sales of real property, if the corporation is engaged primarily in the business of selling real property, are included in the numerator of the sales factor for the state in which the property is located.
3) Sales which consists of receipts from the rental of tangible personal property shall be included in the numerator of the sales factor for the state in which the property is located.

d) All Other Sales--All gross receipts from sales, other than from sales

described in subsection (b) and (c), shall be excluded from both the numerator and the denominator of the sales factor.

Sec. 358. Foreign Source Income.

a) Definition--The term "foreign source income" means:

1) interest other than interest derived from sources within the United States;
2) dividends other than dividends derived from sources within the United States;
3) rents, royalties, license, and technical fees from property located, or services performed without the United States or from any interest in such property, including rents, royalties, or fees for the use of, or the privilege of using without the United States any patents, copyrights, secret processes and formulas, goodwill, trademarks, trade brands, franchises and other like properties; and
4) gains, profits, or other income from the sale of intangible or real property located without the United States.

b) Determination of Source of Income by Reference to Provisions of the Internal Revenue Code of 1954--In determining the source of income for purposes of this Section and Section 303(b), the provisions of Sections 861, 862, and 863 of the Internal Revenue Code of 1954, as amended, shall be applied.

c) Adjustment of Property, Payroll, or Sales Factors--If foreign source income as defined for purposes of this title is derived from property, wages or sales which are otherwise includable in the denominator of a factor described in Sections 355, 356, or 357, either the state or the corporation may determine that the property, wages, or sales from which such foreign source income is derived shall be excluded from such denominator.

Sec. 359. Dividends.

The term "dividends" shall have the same meaning as that term has under the Internal Revenue Code of 1954, as amended, including any sum treated as a dividend under Section 78 of such Code.

Sec. 360. United States.

The term "United States" wherever used in this act shall include only the 50 states and the District of Columbia.

Sec. 361. Limitation on Applicability.

Except as otherwise expressly provided in this act, the definitions and rules set forth in this part shall apply only for purposes of this title.

Title IV--Jurisdiction of Federal Courts

Sec. 401. Judicial Review.

Notwithstanding, Section 1251 (a) of Title 28, United States Code, the United States Court of Claims shall have jurisdiction to review de novo any issues relating to a dispute arising under this act or under the provisions of PL 86-272, as amended. Within 90 days of the decision of state administrative body from which the only appeal is to a court, any party to the determination may petition the Court of Claims for a review de novo of any such issues for purposes of such review, the findings of fact by the state administrative body shall be considered with other evidence of the facts. The judgment of the Court of Claims shall be subject to review by the Supreme Court of the United States as provided in Section 1255 of Title 28, United States Code, as amended.

Sec. 402. Effect of Federal Determination.

Any judicial determination made pursuant to Section 401 shall be binding for the taxable years involved on any state given notice thereof or appearing as as party thereto, notwithstanding any prior determinations of the courts or administrative bodies of that state completed after notice to that state. No statute of limitations shall bar the right of a state or a taxpayer to an amount of tax increased or decreased in accordance with such determination, provided action to recover such amount is instituted within one year after such determination has become final.

Sec. 403. Conforming Amendment to Title 28, United States Code.

Title 28, United States Code, is hereby amended by adding after Section 1507 the following new section:

§ 1508. Jurisdiction to review certain disputes involving state taxation of interstate commerce.

"The Court of Claims shall have jurisdiction to render judgment upon any petition for review under Section 401 of the Interstate Taxation Act of 1979."

Title V--Miscellaneous Provisions

Sec. 501. Prohibition Against Out-of-State Audit Charges.

No charge may be imposed by a state or political subdivision thereof to cover any part of the cost of conducting outside that state an audit for a tax to which this act applies.

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The Commission is composed of 26 members — nine representing the Federal government, 14 representing state and local government, and three representing the public. The President appoints 20 — three private citizens and three Federal executive officials directly and four governors, three state legislators, four mayors, and three elected county officials from slates nominated by the National Governors' Conference, the Council of State Governments, the National League of Cities/U.S. Conference of Mayors, and the National Association of Counties. The three Senators are chosen by the President of the Senate and the three Congressmen by the Speaker of the House.

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