
Comments on House Bill 900:
Should Pennsylvania become
A Voting Member of the
Streamlined Sales Tax Project?

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1. Introduction and Summary

Chairman Raymond, Subcommittee Chairman Steil, and members of the Committee on Intergovernmental Affairs, I want to thank you for the opportunity to present my views on House Bill 900 which, upon enactment, would move Pennsylvania from observer to membership status in the Streamlined State Sales Tax Project that has been underway since early 2000. Should Pennsylvania become a member, it will be able to vote on the development of a model sales and use tax statute. Currently, Pennsylvania is able to attend the periodic meetings of the states, but can not influence policy discussions through voting *per se*. Membership does not obligate the General Assembly to automatically adopt whatever comes out of the Project. Rather, any changes to Pennsylvania sales and use tax law that might be recommended by the Streamlined Project will require the full operation of the legislative process in Harrisburg.

House Bill 900 enables four representatives from Pennsylvania to participate in meetings of the Streamlined Sales Tax Project, and vote on the issues surrounding the development of a model statute at Streamlined Sales Tax Project meetings. House Bill 900 broadly defines the goals of the Project, and puts a number of constraints on what such a model statute should contain. Once the Project recommends its model statute to member states (including Pennsylvania), Pennsylvania's adoption of the model statute would hinge on subsequent legislative action in the Pennsylvania House, Senate, and finally signature by the Governor.

I think this is a reasonable process for the Commonwealth to engage in, although I think replacing four representatives with just the Secretary of Revenue (or his delegate), and obligating the Secretary (or his delegate) to make periodic written and oral reports to the Governor and General Assembly would be an improvement in the bill.

In Section 2, I comment on the broader national issues that brought House Bill 900 to you, and in Section 3 make a few specific comments on the legislation.

2. The Broader Background to House Bill 900 and Current Issues Surrounding State Sales and Use Taxes

2.1 General

The impetus for House Bill 900 derives from national concerns dating back to the mid 1990's that state sales and use taxes were becoming unduly complex, especially with the growing popularity of local option sales and use taxes, and the realization that movement of retail sales from traditional face to face commerce to the internet could have substantial revenue consequences for state and local governments.

The National Tax Association (NTA), a professional association of several thousand tax specialist from academe, federal, state and local government, tax professionals at non-profit organizations such as the American Enterprise Institute, Brookings Institution, Center for Budget Priorities, the legal and accounting professions, and the business community, included discussions of emerging issues at their annual research conferences, and then created a forum for specific discussion of internet tax issues in 1998. Since 1997, I have been researching, writing and giving seminars on the issue of taxation of the Internet in conjunction with the NTA activities as a consequence of being on their Board of Directors, and¹ during 1998-99, participated as a voting member in the NTA Project on the

¹ See: Jon M. Peha and Robert P. Strauss (1997), "A Primer on Changing Information Technology and the Fisc," *National Tax Journal*, 50, 3 (September, 1997) 607-621. http://www.heinz.cmu.edu/~rs9f/peha_strauss97.pdf; Robert P. Strauss (1999), "Further Thoughts on State and Local Taxation of Telecommunications and Electronic Commerce," *State Tax Notes*, 17, 17 (October 25, 1999), 1113-1124. <http://www.heinz.cmu.edu/~rs9f/fta99.pdf>; Robert P. Strauss(2000), "Federal Tax Mechanisms to Enable State Taxation of Final Consumption." Testimony before the Subcommittee on Oversight. House Committee on Ways and Means. U.S. Congress. May 16, 2000.(reprinted in *State Tax Notes*, May 29, 2000 and *Tax Notes*, 87, 12 (June 19,2000),1657-64. <http://www.heinz.cmu.edu/~rs9f/wm00b.pdf>; Karen Clay and Robert P. Strauss(2000), "Trust, Risk, and Electronic Commerce: Nineteen Century Lessons for the Twenty-First Century," , 93rd Annual Conference on Taxation, National Tax Association, Santa Fe, New Mexico. http://www.heinz.cmu.edu/~rs9f/nta_11_12_00_bob.pdf. and "Further Thoughts on Federal Tax Mechanisms to Enable State Taxation of Final Consumption," Testimony submitted for inclusion in the hearing record of the Senate Finance Committee, US Congress, August 1, 2001

Taxation of Telecommunications and Electronic Commerce. It was composed of government representatives, industry representatives, and academics whose work immediately preceded and final report² materially informed the Advisory Commission on Electronic Commerce (ACEC) that Congress established in the 1998 moratorium. Recall that the ACEC was unable to reach agreement on what to recommend to Congress last year.

Here in Pennsylvania, I was invited in March, 1998 by your colleagues in the House to comment on Senate Bill 2,³ and urged, with success, that the local option sales and use tax be dropped from the legislation, because it conflicted with emerging national trends about what the states would have to do in order for there to be some sort of reasonable compromise on state taxation of transactions over the Internet.

One of the outcomes of the NTA and ACEC deliberations was the decision by various state and local organizations⁴ to meet periodically to see if they could take what had been agreed to in these deliberations and begin to work through remaining administrative and policy problems that surround the development of a model sales and use tax statute. The Streamlined Sales Tax Project⁵ has been meeting since early 2000 and is co-chaired by revenue department professionals from North Carolina and Wisconsin.

Currently, 32 states⁶ are participating in a cooperative effort to develop a uniform sales and use tax statute which would accomplish 4 general simplification objectives.

The major components of such simplification are:

- Elimination of local collection of sales and use taxes, and simplification or adoption of one sales and use tax rate per state
- Adoption of the shipping address or credit card mailing address to determine destination state, and uniform sourcing rules
- Adoption of standardized classification of goods and services
- Adoption of standardized administrative rules, including a vendor's discount for upfront software and related implementation expenses, and uniform audit and payment procedures

In addition, 6 states⁷, including Pennsylvania, are observing the activities of the streamlining project. Voting status was accorded to any state as a consequence of the states enacting its own version of House Bill 900.⁸

Given the evident national slow-down in national economic activity and the growing economic uncertainty from the events of September 11, 2001, and the fact that state and local tax receipts have also begun to materially slow

Hearings on Taxation of the Internet. http://www.heinz.cmu.edu/~rs9f/finance_8_9_01.doc,
<http://www.heinz.cmu.edu/~rs9f/fta99.pdf>

² See *Final Report* of the National Tax Association Communications and Electronic Tax Project; available at: <http://www.heinz.cmu.edu/~rs9f/final.pdf>.

³ See Robert P. Strauss(1998), "Is Senate Bill 2 True Local Tax Reform? or Will Buffy (the Property Tax Slayer) Slay You, Me, and the Pennsylvania Economy?" <http://www.heinz.cmu.edu/~rs9f/legis98.pdf>.

⁴ The National Governor's Association and National Conference of State Legislatures, with the assistance of the Federation of Tax Administrators and Multistate Tax Commission began meeting to develop various bilateral strategies and a model sales and use tax law with the assistance of some major national retailers. That activity evolved into the Streamlined Sales Tax Project.

⁵ Their web site is <http://www.geocities.com/streamlined2000/> and reflects their current and past activities.

⁶ Alabama, Arkansas, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, Nevada, North Carolina, North Dakota, Ohio, Oklahoma, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Washington, West Virginia, Wisconsin, and Wyoming. See: <http://www.geocities.com/streamlined2000/participatingstates.html>

⁷ California, Colorado, Connecticut, Georgia, Idaho and Pennsylvania.

⁸ The draft "Uniform Sales and Use Tax Administration Act" contains suggested language for membership and also the draft Streamlines Sales and Use Tax Agreement. It can be found at <http://www.geocities.com/streamlined2000/sstbtn21.gif>

down, the matter of whether or not to subject transactions over the Internet to taxation has much greater urgency than several years ago.

2.2 Expanded Duty to Collect Use Taxes in Return for Substantial Sales and Use Tax Simplification

Since the NTA Project report, various members of traditional and high tech business have agreed to negotiate with state and local government to expand their duty to collect and remit use taxes in return for substantial simplification of existing sales and use taxes. The long term strategy is for the voluntary negotiation to achieve a model statute which the states can live with, and then concerted action by business and the state-local sector at either the state and/or federal level to accomplish both the simplification and effect a meaningful expanded duty to collect. This strategy reflects the realization on the part of business and government that economies, and therefore governments, are increasingly interdependent, and that as technology changes the nature of the market place, our public institutions to finance desired public services must keep pace.

Here, I want to comment briefly on what the national debate over simplification of state sales and use taxes in return for an expanded duty to collect use taxes involves, and an identification of the major issues.⁹

In order to pay for public services that the Pennsylvania Constitution obligates the General Assembly to provide, you have fashioned a system of state and local taxes that tax income, consumption, gross receipts, and various types of wealth. Taxation of transactions over the Internet, as well as taxation of the purchase of Internet access, *per se*, essentially involves state and local consumption taxes---the Internet tax debate thus directly involves state sales and especially use taxes. Recall that sales taxes are imposed on taxable items purchased and consumed in Pennsylvania, while use taxes are imposed on the importation into Pennsylvania of taxable items.

It is settled federal constitutional law that the *rate of tax* on imported items can be no higher than on items purchased within the state. Similarly, it is settled federal constitutional law that if an imported item is taxable, then its domestically purchased counterpart must also be taxable. While it is technically constitutional for a state to tax more lightly or even exempt destination sales or imports of a particular item into a state compared to the taxation of an identical domestic purchase, the realities of how domestic merchants (who vote and make campaign contributions) might view such favoritism has precluded that from occurring.

It is also settled federal constitutional law that remote vendors without a physical presence in the destination state are under no legal obligation to collect and remit use taxes. It is for this reason that catalog sales¹⁰, and sales from other remote vendors such as QVC or the Home Shopping Channel into Pennsylvania over 800 phone numbers do not obligate the vendor to collect and remit use taxes to the Pennsylvania Department of Revenue.

It is crucial, however, to understand that Pennsylvania residents *are legally responsible* under current Pennsylvania use tax law to pay the use tax directly to the Pennsylvania Department of Revenue on such purchases from remote vendors if the item is, in fact, taxable. However, it is well known that individual taxpayer compliance with this obligation is weak to non-existent.

Pennsylvania's sales and use tax has evolved over the decades in terms of rate and base. Among the states, the current sales and use tax base is one of the narrower in that it excludes a wide variety of goods and services from taxation. In terms of tangible purchases, food (in the grocery store), medicine (exemption for over the counter *and* prescription medicines), clothing (partial exemption) are broadly exempt as are a wide range of specific commodities (motor fuel, natural gas and electricity) that are subject to specific excise taxes. Additionally, a wide variety of services (rents, most leases, and, among others, personal legal and accounting services) are exempt from the household sales and use tax. A broad manufacturer's exemption also exists to prevent cascading of sales and use taxes.

⁹ Section 2 follows my earlier testimony before the Committee on Economic Development.

¹⁰ Sales into Pennsylvania by such companies as Lands End or LL Bean, who mail out catalogues and fulfill orders placed by Pennsylvania residents on toll free numbers and ship to Pennsylvania addresses, do not obligate the vendor to collect and remit Pennsylvania use taxes.

Pennsylvania's sales and use tax rate has been 6% since 1968, and, at about \$7 billion/year, currently amounts to about 35% of state tax revenues.

In Pennsylvania, sales and use taxation was the sole prerogative of the state until 1991. In June 1991, Philadelphia's dire financial situation led to your enabling Philadelphia to impose a 1% sales and use tax. In 1993 you enabled Allegheny County to adopt a parallel 1% sales and use tax in conjunction with the elimination of the County, Pittsburgh City and School District personal property taxes; Allegheny County's sales and use tax became effective in July, 1994 with the proceeds being shared to a Regional Asset District and in turn to the municipalities and various arts and cultural organizations in the County. In both cases the Pennsylvania Department of Revenue actually collects and remits the additional 1% sales and use taxes to Philadelphia and Allegheny County. In 2000, Allegheny County sales and use taxes were about \$36 million, about 5.7% of total county government revenues, and about 13% of total county government taxes.¹¹

2.3 Revenue Issues as a Motivation for Simplifying Sales and Use Taxes in Return for Expanded Duty to Collect

There is widespread disagreement about how fiscally important sales over the Internet of tangible personal property are, and what the potential revenue loss will be over the next few years as a result of diversion.¹² Estimation of future current and future revenue losses due to diversion is severely hampered by the lack of accurate data on retail sales over the Internet. In February 2000, the Pennsylvania Department of Revenue revised its estimates of sales and use tax losses due to predicted diversion. It believes that in FY98/9 lost revenues were \$17.5 million, and losses are predicted to grow to \$125 million/year by fiscal year 2002/3.¹³ While most popular attention has focused on diversion through household consumers purchasing via the Internet rather than through face-to-face transactions, some of the larger, national estimates of revenue loss find that most is due to loss of those sales and use taxes currently collected from business to business (B2B) transactions. Nationally, about 40% of sales and use taxes are collected from B2B transactions rather than business to consumer (B2C), and the movement of B2B activity to the Internet is occurring much more quickly than for B2C. In Pennsylvania about 36% of sales and use taxes are collected from business to business transactions.¹⁴

Table 1 displays the most recent (December, 2000) independent national estimates of revenue loss from B2C and B2B diversion. Note that some Internet purchases by households and businesses will replace mail order and toll free telephone methods of purchase. Bruce and Fox (2000) estimated that in 2000, \$2.7 billion of net state sales and use tax revenues were incrementally lost, compared to \$174 billion in actual sales and gross receipts tax collections¹⁵, or 1.6%. By 2003, they expect this to grow to \$10.8 billion in lost state sales and use tax revenues. Bruce and Fox estimate that Pennsylvania's share of the \$10.8 billion national, incremental revenue loss in 2003 would be \$358 million, or almost three times that of the Pennsylvania Department of Revenue's February, 2000 revised estimate.

My purpose in presenting these different revenue estimates is to simply advise you that estimates differ, and that some reasonable people think diversion could be fiscally important in the next several years. I think there is general agreement that sooner or later, diversion could entail significant fiscal risk to the states.

¹¹ See p.23, 2000 Comprehensive Annual Financial Report of Allegheny County Controller. <http://www.county.allegheny.pa.us/controll/tran2000.pdf>.

¹² For an industry perspective, see: Robert Cline and Thomas Neubig (1999), "The Sky is Not Falling: Why State and Local Revenues Were Not Significantly Impacted by the Internet in 1998," *State Tax Notes*, July 5, 1999, p 43.-49.

¹³ Pennsylvania Department of Revenue, Bureau of Research(February, 2000). *The Impact of Electronic Commerce on Pennsylvania Sales and Use Tax*, p. 1.

¹⁴ Raymond Ring, Jr. "Consumers' Share and Producers' Share of the General Sales Tax," *National Tax Journal*, LII, 1 (March, 1999), Table 1.

¹⁵ See <http://www.census.gov/statetax00.html>.

Table 1: Bruce-Fox Estimates of State Sales and Use Tax Losses Due to Diversion of B2C and B2B Sales (\$ Billions)

	1999	2000	2001	2002	2003
Total Business-to-Business via Internet (B2B)	\$106.59	\$244.87	\$486.63	\$821.80	\$1297.80
Less Exempt Sales	-47.54	-105.05	-208.76	-369.81	-616.45
Less B2B on which sales/use tax collected	-34.07	-80.96	-164.77	-281.59	-444.24
Equals B2B Base Loss	24.98	58.87	113.09	170.40	237.11
Less substitution for other remote sales	-12.49	-29.43	-56.55	-85.20	-118.55
Equals Incremental B2B Base Loss	12.49	29.43	56.55	85.20	118.55
Approximate Revenue Loss from B2B (\$ billion)	\$0.80	\$1.88	\$3.61	\$5.44	\$7.57
Total Business-to-Consumer via Internet (B2C)	19.75	37.79	62.59	98.62	140.19
Less Exempt B2C	-8.32	-15.34	-23.53	-32.74	-41.78
Less B2C on which sales/use tax collected	-1.14	-2.60	-5.51	10.54	-20.57
Equals B2C Base Loss	10.29	19.85	33.55	55.34	77.85
Less substitution for other remote sales	-3.60	-6.95	-11.74	-19.37	-27.25
Equals Incremental B2C Base Loss	6.69	12.90	21.81	35.97	50.60
Approximate Revenue Loss from B2C (\$ billion)	0.43	0.82	1.39	2.30	3.23
Approximate Incremental Revenue Loss (\$ billion)	\$1.23	\$2.70	\$5.00	\$7.74	10.80

Source: David Bruce and William Fox (2000), "E-Commerce in the Context of Declining State Sales Tax Bases," *National Tax Journal* LIII, 4, Part 3 (December, 2000), 1373-1388.

Given the reality that state and local governments must balance their operating budgets to provide public services, the evident economic slowdown, and the growing importance of the Internet as a mechanism for modern commerce, governments argue that they need improved fiscal mechanisms that will enable them to collect use taxes from remote vendors.

2.4 Complexity of State and Local Sales and Use Taxes

Business groups from the high tech and traditional retail communities have expressed sympathy for state and local revenue needs; however, they point to several types of complexity which inhibit their ability to collect and remit use taxes even if they elected to do so under current law. First, there are better than 7,500 local governments which impose sales and use taxes, and in several states, most notably Arizona, each municipality which elects to impose the sales and use tax can decide on what is exempt, what is taxable, and what the rate of tax is. Business groups argue that it is impossible without significant expenditure on their part to ascertain what the taxable base is, and it is equally difficult to determine the rate of tax for so many jurisdictions.

Second, among the states, not only are there differences in what is taxable and what is not, there is no agreed upon standard set of definitions of commodities and services that all the states currently embrace. Third, the vendor registration requirements, forms, and calendars of filing vary across the states. Especially for small Internet vendors, this can make compliance expensive. Table 2 displays the variability in the structure of state sales and use tax laws.

Table 2: Characteristics of State Sales and Use Tax Laws

Characteristic	States	Total	States
No local option sales and use taxes (single sales/use tax rate)	10	10	Connecticut, Indiana, Kentucky, Maine, Maryland, Massachusetts, Michigan, New Jersey, Rhode Island, West Virginia
Allow local option sales and use taxes (single rate)	2	12	DC, Hawaii
Allow local option sales tax (multiple rates); no local option use tax (single rate)	6	18	Idaho, Illinois, Iowa, Kansas, New Mexico, Vermont
Allow local option sales and use taxes (multiple rates)	29	47	Alabama, Alaska, Arizona, Arkansas, California, Colorado, Florida, Georgia, Louisiana, Minnesota, Mississippi, Missouri, Nebraska, Nevada, New York, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, Wisconsin, Wyoming

Source: Streamlined Sales Tax Project, *Draft Issues Papers and Proposals, No. 2*, pp. 17-18, August 11, 2001
<http://208.237.129.206/sline/aug01IP.pdf>

2.5 State Heterogeneity of Sales and Use Tax Base as Indicator of Complexity

Above, I suggested that current state sales and use taxes are long over due for reform. One indicator of how disparate these taxes are among the states is the extent to which business inputs are taxed (rather than just household purchases) among the states. Table 3 displays recent estimates by state of the extent to which households (Column 3) and non-households or essentially business (Column 4) pay sales and use taxes. On average about 40% of sales and use taxes are paid by business; the range is from 11% (West Virginia) to 72% (Hawaii).¹⁶ Table 3 also indicates what a reformed state sales and use tax system might entail were only final household consumption taxed rather than the mixture of business and household purchases. Current state and local sales and use taxes are thus far from transparent, and, in my view, nothing citizens in each state should be particularly proud of as a way to finance their public services.¹⁷

¹⁶ The non-household share, Column [3] in Table 2, can be thought of as the ratio of (E + G) to (A + C + E + G) in Table 1.

¹⁷ One often hears from the high tech community that it is more sensible to base consumption taxes on the *origin* principle rather than the current state and local (and international) standard of *destination* principle. Dividing geographic principles (origin for the Internet, destination for the rest of commerce) is easily a recipe for tax planning that would result in the claim that all sales originated in sales tax free states such as Oregon. Further, it would create ambiguity and confusion over which kinds of transactions would be subject to origin vs. destination sourcing rules.

Perhaps the most obvious argument in favor of destination as a sourcing rule involves the simple admission that the purpose of taxation is to pay for public services which residents enjoy. Given the obvious incidence of final consumption based taxes (on final consumers of the goods and services), placing taxation where the public services are enjoyed makes the most sense and avoids the most confusion and tax planning opportunities.

Table 3: State Sales and Use Tax Rates, Household's Share, and Estimated Final Consumption Sales and Use Tax Rates

State	January, 2000 State Sales & Use Tax Rates	Household Fraction Of Sales & Use Taxes	Non-Household Fraction of Sales & Use Taxes	1998 Sales Taxes as % of State Personal Income	1998 Sales Taxes as % of State Personal Outlays	Final Consumption State Sales and Use Tax Rate	Final Consumption State Rate as % of Current State Rate
	[1]	[2]	[3]	[4]	[5]	[6]	[7]
Alabama	4.0%	73.0%	27.0%	1.8%	2.2%	3.1%	76.3%
Arizona	5.0%	50.0%	50.0%	2.4%	3.0%	6.0%	119.4%
Arkansas	4.6%	60.0%	40.0%	2.9%	3.7%	6.1%	132.7%
California	6.0%	53.0%	47.0%	2.4%	3.0%	5.6%	93.5%
Colorado	3.0%	60.0%	40.0%	1.3%	1.7%	2.8%	93.8%
Connecticut	6.0%	58.0%	42.0%	2.5%	3.1%	5.3%	89.0%
Florida	6.0%	50.0%	50.0%	3.3%	4.2%	8.4%	140.2%
Georgia	4.0%	64.0%	36.0%	2.1%	2.6%	4.1%	101.8%
Hawaii	4.0%	28.0%	72.0%	4.1%	5.1%	18.2%	455.4%
Idaho	5.0%	62.0%	38.0%	2.5%	3.2%	5.1%	102.4%
Illinois	6.3%	68.0%	32.0%	1.7%	2.1%	3.1%	48.9%
Indiana	5.0%	54.0%	46.0%	2.2%	2.8%	5.2%	103.1%
Iowa	5.0%	59.0%	41.0%	2.2%	2.8%	4.7%	94.8%
Kansas	4.9%	67.0%	33.0%	2.5%	3.1%	4.6%	94.4%
Kentucky	6.0%	54.0%	46.0%	2.8%	3.5%	6.5%	107.7%
Louisiana	4.0%	51.0%	49.0%	2.4%	3.0%	6.0%	149.4%
Maine (4)	5.5%	57.0%	43.0%	2.9%	3.7%	6.4%	116.5%
Maryland	5.0%	60.0%	40.0%	1.7%	2.2%	3.6%	72.6%
Massachusetts	5.0%	62.0%	38.0%	1.5%	1.8%	3.0%	59.3%
Michigan	6.0%	58.0%	42.0%	3.0%	3.8%	6.5%	108.9%
Minnesota	6.5%	56.0%	44.0%	2.8%	3.6%	6.4%	97.9%
Mississippi	7.0%	66.0%	34.0%	3.9%	4.9%	7.4%	106.0%
Missouri	4.2%	64.0%	36.0%	2.0%	2.5%	3.9%	92.2%
Nebraska	5.0%	60.0%	40.0%	2.2%	2.8%	4.7%	93.2%
Nevada	6.5%	44.0%	56.0%	3.7%	4.7%	10.6%	163.4%
New Jersey	6.0%	62.0%	38.0%	1.7%	2.2%	3.5%	58.6%
New Mexico	5.0%	50.0%	50.0%	4.5%	5.6%	11.3%	225.2%
New York	4.0%	66.0%	34.0%	1.4%	1.7%	2.6%	65.8%
North Carolina	4.0%	62.0%	38.0%	1.8%	2.3%	3.7%	91.4%
North Dakota	5.0%	60.0%	40.0%	2.6%	3.3%	5.5%	110.8%
Ohio	5.0%	66.0%	34.0%	2.0%	2.5%	3.7%	74.8%
Oklahoma	4.5%	66.0%	34.0%	2.7%	3.4%	5.2%	114.9%
Pennsylvania	6.0%	64.0%	36.0%	2.0%	2.5%	3.9%	64.3%
Rhode Island	7.0%	59.0%	41.0%	2.0%	2.5%	4.2%	60.4%
South Carolina	5.0%	61.0%	39.0%	2.7%	3.4%	5.5%	109.8%
South Dakota	4.0%	61.0%	39.0%	2.7%	3.4%	5.5%	137.8%
Tennessee	6.0%	63.0%	37.0%	3.1%	4.0%	6.3%	104.6%
Texas	6.3%	53.0%	47.0%	3.0%	3.8%	7.2%	115.2%
Utah	4.8%	63.0%	37.0%	2.9%	3.6%	5.8%	121.2%
Vermont	5.0%	56.0%	44.0%	2.2%	2.7%	4.8%	96.7%

State	January, 2000 State Sales & Use Tax Rates	Household Fraction Of Sales & Use Taxes	Non-Household Fraction of Sales & Use Taxes	1998 Sales Taxes as % of State Personal Income	1998 Sales Taxes as % of State Personal Outlays	Final Consumption State Sales and Use Tax Rate	Final Consumption State Rate as % of Current State Rate
	[1]	[2]	[3]	[4]	[5]	[6]	[7]
Virginia	3.5%	70.0%	30.0%	1.4%	1.8%	2.6%	74.0%
Washington	6.5%	49.0%	51.0%	3.1%	3.9%	8.0%	123.4%
West Virginia	6.0%	89.0%	11.0%	2.8%	3.6%	4.0%	66.7%
Wisconsin	5.0%	62.0%	38.0%	2.3%	2.9%	4.7%	94.3%
Wyoming (3)	4.0%	54.0%	46.0%	3.0%	3.8%	7.0%	174.9%
Mean	5.2%	59.4%	40.6%	2.5%	3.1%	5.6%	111.1%
Std Dev	1.0%	8.8%	8.8%	0.7%	0.9%	2.7%	61.4%
Min	3.0%	28.0%	11.0%	1.3%	1.7%	2.6%	48.9%
Max	7.0%	89.0%	72.0%	4.5%	5.6%	18.2%	455.4%

Notes: Column [1] from Federation of Tax Administrators WebPages www.taxadmin.org; 2000; Column [2] and [3] from Raymond Ring, Jr. "Consumers' Share and Producers' Share of the General Sales Tax," *National Tax Journal*, LII, 1 (March, 1999), Table 1, p. 81; Column [4] John L. Mikesell, "Retail Sales Taxes, 1995-98: An Era Ends," *State Tax Notes*, Table 4, pp. 592-3. Column [5]= Column [4] / .794, the ratio of 1998 BEA Consumer Outlays/BEA Personal Income; Column [6]=Column [5] / Column [2]; Column [7]=Column [6] / Column [1]

The Pennsylvania row of Table 3 indicates that were Pennsylvania to only tax households on *all* of their consumption, the current sales and use tax rate could be lowered from 6% to 3.9%. This would involve moving about 36% of the current sales and use taxes paid by business to households. In states such as Washington, in which business sales and use tax cascading is very heavy, the rate of sales and use tax would have to be *increased* from 6.5% to 8% in order to bring in the same amount of revenues.

3.0 Specific Comments on House Bill 900

Harmonizing the very disparate state and local sales and use taxes through a multi-state negotiating process has proven difficult, but not impossible. Several of the states are working with hardware and software vendors to develop technology solutions to the problems of determination of the customer's state of residence, business registration, commodity classification, real-time transfer of funds from remote vendor to destination state revenue agencies. States actively participating in this process of negotiating the myriad details of a harmonized sales and use tax system and engaging with serious industry and business participants about the workability of alternative solutions are not only helping to devise a model system, they are also learning much about how to improve their current sales and use tax administration, because these discussions are occurring outside the normal adversarial discussions that occur in taxpayer-tax administrator disputes.

House Bill 900 generally follows the suggested language the Project worked out for states interested in achieving member status. Time limitations precluded my researching what other states actually enacted to attain member status. Presumably that information can be developed by contacting the Project, NGA or NCSL, if the Committee is concerned about that sort of comparability of House Bill 900 with actions taken by other states. I should note that a number of member states are already legislatively considering simplified sales and use tax statutes; you can find the status of those activities on the Project's web page.

Attaining membership status in the Streamlined Project is desirable for several reasons:

- a) it gives Pennsylvania a stronger say in how the model sales and use tax statute is developed;
- b) voting on suggested reforms via this process will help us to understand better our own sales and use tax law and practice in comparison to those in other, competing states; such learning seems eminently desirable; and,
- c) Pennsylvania's more active participation will more generally support state sales and use tax simplification and reform that, in my judgment, is long overdue among the states.

While I support enactment of House Bill 900, I do suggest, however, that you revisit the representation structure contemplated in Section 4. As currently drafted, it seems to me to be unduly complicated with 4 representatives (2 from the Executive Branch and 2 from the Legislative Branches of government) being sent to speak on behalf of the Commonwealth. Certainly an even number of representatives creates the possibility there could deadlock were they to vote among themselves on a particular policy position; this does not seem to serve the Commonwealth's interests when participating in national negotiations.

Authorizing the Secretary of Revenue (or his delegate) to solely represent the Commonwealth with an obligation to make periodic (perhaps semiannual) written and oral reports to the Governor, House and Senate would seem to allow the Commonwealth to speak with one voice and keep elected officials informed about where the Project is going and what Pennsylvania's position is in relation to these negotiations.

Since the goal of the Project is to simplify sales and use tax administration, I think the executive agency in charge of state tax administration should be the primary negotiator for the Commonwealth. Tax administration is not simple; it involves issues of tax law and regulation, accounting rules and practice, information technology, compliance and privacy, and the management of their change, as well as the more obvious revenue and tax burden issues that arise when potentially changing the nature of the sales and use tax base.

The Secretary of Revenue is appointed with the consent of the Senate; this provides adequate accountability that will ensure that he or she represents the interests of the executive and legislative branches of the Commonwealth. The Secretary of Revenue with staff support or a senior staff person (one of the Deputy Secretaries) in Revenue with staff support would be sent to Project meetings to speak for the Commonwealth. As revenue policy issues arise over what should be taxable and what should be exempt in the model tax base, I am confident that whomever goes will have many side bar conversations with the Governor and his staff, members of the committees of jurisdiction, and stakeholders in the Commonwealth.

I should note that both the general draft bill available from the Project that effects membership and House Bill 900 contain a number of heavily negotiated items which may strike the reader as peculiar and which deserve initial comment. Both of the following issues arose during the deliberations of the NTA Project, and, while I would urge that you leave these sections intact, I think both will be revisited when third party electronic collection and payment of use taxes to destination states becomes operational. The first issue involves provision of a safe haven from nexus attribution (Section 7 (4)) for any business that registers centrally and collects and remits in signatory states under the final Project's model statute; the second involves a safe haven against any vendor liability (Section 10 (2)) for any vendor who collects and remits through an electronic third party service.

Nexus, as you know, is the responsibility to file a tax return and pay over monies for a given tax, and thereby comply with the statute and regulations governing that tax in a given state. What Section 7 (4) basically does is eliminate any risk of a state finding nexus as a consequence of a seller registering and collecting sales and use tax through a central authority that one might expect to arise with the operation of a model sales and use tax statute. The business community is concerned that such registration and collection and remitting activities should not implicate possible nexus responsibilities for other taxes, e.g. business gross receipts or business net income taxes. I can appreciate business concerns that cooperating in one area of interstate taxation should not create further obligations in other tax areas; however, I do not believe that absent this clause they would be at risk of nexus claims under taxes should they engage in registration or collection.

More significant to the states, however, is the safe haven for sellers under certain conditions from liability and audit under Section 10 (2). If a seller contracts with a certified third party to process transactions, the seller is not liable for sales or use tax on transactions processed by the certified third party unless the seller commits fraud or misrepresents the item in the transaction (calls a taxable item something else that is tax exempt so no tax should be collected). Moreover, the seller is not subject to audit for such transactions. Under current law, vendors are subject to substantiation of the accuracy of their collection activities and must permit a review of books and records. Often sales and use tax audits involve a sampling of transactions to ascertain if the seller is appropriately collecting and remitting its sales and use taxes. Section 10 (2) establishes a standard, probable cause that the seller commits fraud or engages in material misrepresentation, which provides a safe haven for the seller from any audit activity under any model statute. Given the likely gravitation of retail commerce to the web, I think the states are unduly

handicapping themselves by not allowing them to do sample audits of sellers who use certified third party agencies to collect and remit sales and use taxes. While I think a presumption of honesty is noble, this presumption is much more generous than current sales and use tax law which authorizes the Pennsylvania Department of Revenue to examine the books, papers, and records of any sales and use taxpayer and to require the preservation of such books, papers and records for three years.

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