
**Federal Tax Mechanisms
to Enable
State Taxation of Final Consumption**

Robert P. Strauss*

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*Professor of Economics and Public Policy, H. John Heinz III School of Management and Public Policy, Carnegie-Mellon University, Pittsburgh, Pennsylvania, 15213-3890. Email: RS9F@Andrew.CMU.Edu; Home Page: <http://www.heinz.cmu.edu/~rs9f>. The views and opinions in this testimony are solely those of the author, and do not represent those of Carnegie-Mellon University.

“To do what’s right is easy, to know what’s right to do...that’s an entirely more difficult matter. “
---President Lyndon B. Johnson

1. Introduction

Chairman Houghton, Congressman Coyne, and members of the Ways and Means Subcommittee on Oversight, I want to thank you for the opportunity to testify this afternoon on certain state tax issues which arise from commerce occurring over the Internet. It has not been fashionable in recent years to view federal, state, and local taxes as intertwined. However, growing world economic interdependencies due to the spread of market economies and technological change obviously imply greater financial interdependencies for our governments.¹ It is my judgment today that the states can not resolve such issues themselves. Federal legislation is necessary for the states to have a sensible *structure* of revenue instruments which will allow them to decide the rate of consumption tax necessary to finance the level of public services they agree on. As an alumnus of the US Treasury and Staff of the Joint Committee on Internal Revenue Taxation, I have some preference that such federal legislation as I describe below be the responsibility of the tax writing committees of Congress. You and your staffs have the expertise to deal with the complexities of design and fiscal implications of such design.

There is a need in my view for a steadying federal hand in both the areas of electronic commerce and its taxation. In the case of especially retail electronic commerce, it will not flourish until there are in place, counterpart to existing paper institutions, electronic institutions that establish trust, customer-merchant and merchant-customer protections. It is difficult to envision Americans parting with large fractions of their incomes across the net for goods and services unless they are certain they are as protected as when they engage in face to face commerce. Since much of the appeal for electronic commerce is its increased speed across jurisdictional boundaries, only the federal government can effectively devise systems of standards that will make the appeal a reality. Related to the establishment of various standards for authentication, electronic record-keeping, and electronic notary services, is the supervision of such trusted third parties. For example, as the IRS and tax committees of Congress are learning, simply enabling but not closely supervising private agencies to transmit important electronic documents does not always work as planned.

In my remarks to you this afternoon, I shall address alternative ways the tax committees of Congress can, through federal legislation, enable the states to deal constructively with their various consumption taxes. My focus will be on the use tax problems that arise from inter-state retail sales on the Internet, and alternative ways federal legislation can solve them.

2. The Problems of State Sales and Use Taxes and Possible Federal Roles

2.1 Problems of State Sales and Use Taxes

Over time, state personal and corporate income taxes have become increasingly similar to their federal counterparts. Because there is no federal retail sales tax, there has been no comparable federal template for the states to choose to gravitate to. As you know, state sales and use taxes are extremely important to state budgets, and in some states, the same is true for local sales and use taxes. Among the states, the structure of state sales and use taxes vary considerably. Whether the seller or customer is liable for the tax, the precise nature of whether a good or service is taxable, the rate, and a myriad of other administrative provisions vary. As a result, it is very difficult for a customer or vendor new to a state, let alone a local area, to be confident about what their duty to collect and remit is.²

¹ The original 1913 federal personal income tax recognized such interdependencies by requiring all taxpayers to deduct state and local taxes in arriving at federal taxable income. At that time, federal ability to pay was thought to occur *after* taxpayers took care of their state and local tax responsibilities.

² See, Due, John and John L. Mikesell (1994). *Sales Taxation: State and Local Structure and Administration*. Second Edition. (Washington, D.C.: Urban Institute Press, 1994).

Also, the fact that current sales and use taxes are substantially imposed on business input purchases is troubling from both economic and political perspectives. Such hidden taxes encourage purely tax motivated changes in business form (vertical integration), and hide from voters true tax burdens.

Table 1 displays the design decisions each state makes with regard to its sales tax. The Constitution and Supreme Court decisions require that consumption taxes in classes A and C, and E and G be the same. From an economic perspective, state sales and use taxes would be much better were activities in classes E-G in Table 1 not taxed. Similarly, state sales and use taxes would be much better (and easier to administer) if the exemptions in the final consumption tax base, B and D, were as small as possible. The stricture “broad base, low rate” is as applicable to household or final consumption taxes as it is to income taxes.

Table 1: Classification of State Consumption Tax Design Problem

Geography of Activity	Final Consumption		Intermediate Production	
	Taxable	Exempt	Taxable	Exempt
Sales	A	B	E	F
Use	C	D	G	H

How much are business inputs taxed by current state sales and use taxes? Table 2 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).³ (We shall return to Table 2 when I discuss what a reformed state sales and use tax system might entail.) 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.

³ 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.

Table 2: 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%

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]
Vermont	5.0%	56.0%	44.0%	2.2%	2.7%	4.8%	96.7%
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 Webpage www.taxadmin.org;

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 other emerging problem of state sales and use taxes, and the immediate reason for this hearing, is the likely erosion of states sales and use tax bases as retail electronic commerce grows. As you know, under *Bella Hess* and *Quill*, the states are not able to obligate remote sellers without a physical presence to collect and remit use taxes, although their residents remain legally obligated to pay them. Traditional merchants find themselves increasingly at a disadvantage as remote electronic vendors join remote mail and phone catalog vendors in arbitraging on price differentials that reflect use taxes not being collected. Business equity issues are thus becoming more pronounced. Michigan's experiment last month, which puts a use tax line on its personal income tax return⁴, is carefully being watched by other states. However, vendor collection and remittance at the time of sale makes far more sense and eliminates customer record keeping. How might the federal government assist the states in obtaining better compliance with its use taxes?

2.1 Alternative Federal Roles

State Piggybacking onto New Federal Retail Sales Tax

Periodically, there has been discussion about the desirability of moving to a federal consumption tax--either a value added tax or retail sales tax. In conjunction with such a redesign of federal revenues, it has been suggested that the states could piggyback onto federal administration. Time and space limitations do not permit an extensive discussion of whether or not it is a good idea to now consider a federal retail sales tax as a mechanism for either fundamental federal tax reform or as a way to help the states. However, let me state my conclusion, having looked at the issue closely several years ago,⁵ that the economic argument favoring federal consumption tax as a cure to lackluster economic performance is not as persuasive today as it was a decade ago. Even if the federal government were to enact its own national retail sales tax, it is unclear whether or not the states would be drawn to such a template, especially if they did not retain control of their own rate of tax.

⁴ Line 30 of Michigan's personal income tax return, MI-1040, asks the taxpayer to report use tax due from a worksheet.

⁵ Robert P. Strauss, "Administrative and Revenue Implications of Federal Consumption Taxes for the State and Local Sector," *State Tax Notes*, 15, 5 (February 1, 1999), 327-338.

Federal Revenue Sharing to States of New Federal Retail Sales Tax

Were the federal government to enact a national retail sales tax and then share back some or all of the revenues to the states, the states would still likely want to maintain their own sales and use taxes, although they might reduce reliance on their own. Issues of sovereignty would undoubtedly arise while the method or formula for federal revenue sharing would likely be a difficult issue for Congress to resolve. Moreover, this approach might not readily deal with the above mentioned use tax problems should the states retain their own sales and use taxes, nor would it deal with cascading or complexity issues either.

Federal Assistance/Insistence but not Federal Collection of State Use Taxes

If state piggybacking onto a new federal sales tax is not in the offing and revenue sharing is also not a plausible solution to state use tax issues, then what? What follows involves a solution based on the following tax policy pieces:

a) agreement to dramatically simplify state sales and use taxes though state absorption of local sales and use taxes and the keeping whole of local governments which give up their local sales and use taxes,

and

b) federal assistance/insistence to ensure that remote vendors collect and remit use taxes.

To these I would add the elimination of sales and use taxes currently imposed on business inputs. However, the ideas which follow can be put together without this. What is essential is one definition across all states imposing a consumption tax of what constitutes taxable consumption so that intra and inter-state vendors can readily determine if the purchase is taxable or not.

3. The Grand Political Trade

In good measure the growing complexities which traditional multi-state vendors were experiencing with local sales taxes as well as growing concerns states were having about use tax collections from catalog and Internet vendors precipitated industry-government discussions at the NTA Project and then ACEC. The basic idea still being discussed is to:

legislatively overturn *Bella Hess* and *Quill* through an expanded duty on remote sellers to collect and remit use taxes to the jurisdiction of destination or use currently without such obligation

in return for

a vastly simplified sub-federal sales and use tax system that would eliminate intra-state diversity in sales and use taxation, and standardize administration across the states⁶.

Under this grand trade, states would agree to move to one tax rate per state that was revenue neutral, and business would join with state and local government to find suitable legislative vehicles to make it a reality. Some of the participants in the NTA Project also hoped that sales and use tax simplification would also lead to reform, e.g. agreement on a uniform *final* consumption tax base.

Much of the impetus for extending the moratorium for a long period of time(say 5 years) is to give the states sufficient time to work out among themselves just what a simplified system might be. However, I am doubtful that such a voluntary or cooperative approach can work, and suggest that with some federal assistance or insistence, the states can readily adopt a model statute, with many simplifications, that will make the above grand political trade a reality. Below, I sketch out the essential pieces to this.

⁶ Periodically the states have said they would engage in revenue sharing intra-state to keep those local governments now dependent on local sales and use taxes whole.

4. Simplifying and Reforming State Sales and Use Taxes

There are two ingredients to devising a new system of state sales and use taxes:

- Creating a definition of final taxable consumption for all states with sales and use taxes that is workable, and
- Finding a credible mechanism to enforce the expanded duty to collect on remote vendors (e.g., catalog and Internet)

4.1 Defining Final Taxable Consumption

There are several reasons to favor the states moving to the same definition of household consumption. First, it makes administration much more simple, especially for remote vendors, since one need not keep track of the extraordinary fine distinctions among goods and services which the states have made over the years for public policy and other reasons. Second, a broader base means that the rate of tax can be lower, and thus have a smaller impact on consumption choices made by households. Third, by just taxing final consumption, the states will inform their citizens about what the tax costs of government are.

Historically there have been a variety of approaches to define what is taxable under state sales and use taxes, and how to exempt certain items, either in terms of the nature of the customer, or in terms of the nature of the good or service. A rather simple way to move a household final consumption sales and use tax base is to reverse the way sales and use tax laws are typically drafted, and to introduce a new construct for sales and use tax purposes, the “taxable person.”

Under the taxable person approach, sales and use taxation is an *exception* to a general *prohibition* on the taxation of anything. The exception is for *anything* purchased for or purchased by a “taxable person” for “non-business use”. What is a “taxable person”? A “taxable person” is any natural person (and thus *not* a corporation or other recognized legal form of a business or government). “Purchase” would cover any consumer purchase or rental. This concept is quite broad; for example, consumer services would be automatically covered under this definition since they are paid for by a natural person who is not a business.⁷ The first phrase, “purchased for” is necessary for sole proprietorships, and for closely held businesses, and more generally to avoiding passthroughs from businesses to persons as a way to circumvent the sales and use tax.

How might such a system work in the world of web commerce? Unless a purchaser had a registration certificate, *any* purchase, main street or remote, would be taxable at a single state rate. Provision of the business registration number by the agent for the company making the purchase would preferably be in a uniform format (a single national registration form with a single structure to the registration number) and provided in a secure (encrypted) form to the seller. Just as a seller has to confirm the authenticity of a credit card number and any other identifying information prior to agreeing to the sale, the seller would confirm the business registration certificate number at a regional or central clearinghouse that would maintain this information in a secure fashion. To ascertain whether or not the purchase is a pass-through for personal use, the purchaser would have to be queried about this, and the proper response noted and recorded. The final issue involves the destination of delivery or use, and the application of the correct state sales and use tax rate. Again, the purchaser would need to be queried as to this and the seller would have to record it.⁸

⁷ Third party payments (e.g. health insurance) are a gray area but would seem to be an example of a business pass through to an individual which would thus be taxable to the third party (regardless if it was tax exempt or not). Anything purchased for personal use would be covered by the non-business use.

⁸ Evidently the new Russian Federation’s Regional Sales Tax appears to be structured in a similar manner. See John L Mikesell, “Structure of the Russian Federation’s New Regional Sales Tax,” *Tax Notes International*, 18 (March 15,1999).

Table 2 contains some preliminary estimates about what the range of sales and use tax *rates* might be if the tax base were final consumption rather than the current amalgam of both some household and some business purchases. Moving to broad-based final consumption from a hybrid base entails first a base narrowing in order to tax just households, and then a base broadening to include all items of consumer outlay. Column [6] of Table 2 displays by state a rough estimate of what the equal yield tax rate would have to be if the base were household outlays. The mean final consumption state sales and use tax rate is 5.6% compared to the current mean sales and use tax rate of 5.2%. Alabama could cut its current 4% state rate to 3.1% if it levied it on all final household consumption. Similarly, California could lower its rate from 6% to 5.6%, and so forth. For states that have heavy tourism, such as Florida, Hawaii, and Nevada, the estimated final consumption tax rates undoubtedly overestimate the extent of change that would have to occur. Of course, if the model sales and use tax statute were to exempt necessities such as food, clothing, and medicine, then equal yield rates would have to be higher. I view these first estimates as generally encouraging.

4.2 Four Federal Approaches to Assisting/Insisting on An Expanded Duty to Collect and Remit Use Taxes

After the issuance of the NTA *Final Report* in September, 1999, the National Governors Association and National Conference of State Legislators began developing a proposal which they believed would enable the states through bilateral, cooperative agreements to obligate businesses which originated inter-state sales to remit to the destination state as a consequence of the cooperative agreement being in place. The states evidently view this approach to eliminating the need to come before the Congress to ask for federal legislation. Elsewhere⁹ I have characterized this as “each state permitting the other to fiscally hunt in the dark.” I am not alone in such pessimism, and I have heard that some governors are now wondering if their bilateral approach can be timely, practical and effective.

Certainly, there is no impediment to the Congress legislating to assist the states under its taxing or commerce powers. The general solution to what is usually called the tax harmonization problem I develop below involves federal participation to ensure compliance of remote vendors to collect and remit, but one that stops a bit short of actual federal piggybacking.

One set of federal solutions lies in constructing a tentative (federal) tax which may be offset by a credit for other “qualified” (state) taxes that the seller collects and remits directly to the states. Failure to collect and remit means loss of the credit, and the payment of the tentative tax to the federal government rather than in effect zeroing it out with the payment of the state tax. Since there is a tentative federal tax, there will necessarily be a federal review of books and records (federal audit), and oversight of the remittances so they go to the proper state.

Another set of federal solutions entails a free-standing federal penalty tax should non-compliance to collect and remit occur.

4.2.1 Hollings S1433

In July, 1999 Senator Hollings introduced S1433 whose purpose was to impose a federal tax on internet or catalog sales at a rate of 5%, but which could be offset by a credit for collection and remittance of state and local sales and use taxes at rates of up to 5%. The bill created the construct of sales by a “local merchant” to which the tentative tax and credit would *not* apply. The net federal proceeds of such an approach would go into a trust fund whose proceeds would be used by the Secretary of the Treasury to make grants, based on a population and poverty allocation formula, to each state and the District of Columbia to supplement salaries of primary and secondary public school teachers.

The Hollings mechanism puts extreme pressure on the states to adopt use tax rates at 5%. This arguably will have a chilling effect on state sovereignty that might be far worse than pure piggybacking because most piggyback models permit state discretion in tax rate, but use a purely federal collection mechanism.

4.2.2 Expand FUTA Eligibility Requirements to Include Expanded Duty to Collect

⁹ Robert P. Strauss, “Further Thoughts on State and Local Taxation of Telecommunications and Electronic Commerce,” *State Tax Notes*, 17, 17 (October 25, 1999), 1113-1124.

A second variant of this type of harmonization, and one that is more workable in my view, is to utilize an existing well harmonized federal-state tax instrument. What I have in mind here is to utilize the historical harmonization of federal and state unemployment taxes as a vehicle for assuring that the new duty to collect and remit use taxes is in fact honored. The idea would be to amend eligibility for the FUTA tax credit to require positive agreement by an employer to participate in the collection and remittance of the newly enabled use taxes. Remote sellers of any consequence have employees, and are thus necessarily involved in existing federal and state unemployment compensation programs. As a result, they are already subject to audit and regulation by both IRS and the US Department of Labor and their state counterparts.

Under this scheme, qualification to take the historical credit for state unemployment taxes against the tentative federal unemployment tax would simply entail a new responsibility, namely demonstrably agreeing to collect and remit use taxes enabled under the grand political trade. One would amend current FUTA requirements to include reporting about all sales and the use tax remittances to aid in administration and audit. Under this approach, the states retain control over their use tax rates, get remittances directly from remote sellers, and IRS would perform some audit and oversight functions, but not deal with each transaction. This approach would also allow remittance mechanisms to evolve as technology develops, and as the market place provides software solutions to remote sellers. It is reasonable to expect that some form of vendor discount be made available to amortize the costs of such software investments.

Whether or not the unemployment system can or should handle this new responsibility remains an open question. Also, given that current state use tax rates are in the 3-7% range, it is possible that remote vendors might simply forego taking advantage of the federal credit since 3 to 7% of their gross sales would dwarf any federal offset of state employment taxes.

4.2.3 Conditional 10 % Federal Sales Tax

Another, related way to encourage remote vendors to collect and remit use taxes would be to obligate any federal taxpayer, engaged in remote sales, to pay to the IRS an excise equal to 10% of its sales, *unless* it agreed to collect and remit use taxes to each destination state which had in place a reformed sales tax base contained in federal law (e.g. per Section 4.1 above) at the state's use tax rate. If a state did not have in place the reformed or "qualified sales and use tax", the state would not benefit from federal insistence on the remittance of the use tax. This would enable all non-sales tax states to remain sales tax free. As long as taxpayers collected and remitted, IRS would never see or touch any of the use tax monies. With suitable administrative mechanisms in place, states would continue to enjoy fiscal autonomy by virtue of having control (with suitable notification) of their sales and use tax rates.

Compliance with this obligation to collect and remit would entitle the taxpayer to an exemption from the 10% federal sales tax. Presumably all taxpayers would understand they would do much better by collecting and remitting the use tax than standing in non-compliance and be subject to the 10% federal tax.

4.2.4 10 % Federal Penalty Approach

A variant on the conditional 10% federal sales tax would be to structure the relationship between the taxpayer and a federal agency as a penalty for non-compliance, given that the destination state had in place a "qualified state sales and use tax." Now, the penalty would be measured by a high percentage (e.g. 10%) applied to the taxpayer's sales. Arguably the penalty approach could be acted upon by a committee other than a tax committee of the Congress, although there would be a question of which federal agency to turn over any possible proceeds, as well as a question of which federal agency, if not Treasury/IRS, would be responsible for determining that any state indeed had in place a "qualified" sales and use tax.

An advantage of these approaches is that they could be devised to leave both *Quill* and *Bella Hess* undisturbed, and thus not raise any nexus issues in *other* areas of state taxation (e.g. business income or franchise taxes). Remote vendors would be collecting and remitting simply to forestall an adverse, federally imposed financial consequence. By the same token, any state which felt strongly that its current sales and use tax base, imposed partly on households and partly on business, rather than on final consumption, was more meritorious than a "qualified state sales and use

tax” could continue to enjoy its sovereignty over base and tax rate. In this circumstance, remote vendors would not be obligated under threat of federal penalty to collect and remit use taxes. Of course, such states would continue to find use tax remittances lagging, and, as electronic retail commerce grows, this could have increasingly serious financial consequences to them.

Congress might find legislating under this second approach somewhat easier, because you would not be requiring *per se* that each state with a sales and use tax to necessarily adopt the “qualified state sales and use tax.” Greater state sovereignty would be, of course, at the expense of simplification, ease of administration and compliance, and elimination of tax cascading.

5. Concluding Comments

The objective of my remarks has been to explain several different ways the tax committees of the Congress might assist the states in moving to a simplified system of sales and use taxes, and in so doing ensure that remote vendors, currently without a duty to collect and remit use taxes, would do so in the future. The ideas I have presented contemplate a more integrated vision of tax policy in our federal system than has been fashionable in recent years. But it may also anticipate that, because our daily lives are increasingly affected by events far away, our fiscal institutions need to adapt as well. Federal leadership requires Congressional action. State cooperation to accomplish inter-state tax harmonization of state sales and use taxes, but without federal legislation, seems well intentioned, but not likely to be fruitful.

The range of federal interventions I have suggested, various kinds of federal taxes to be imposed unless states have more uniform sales and use taxes, and vendors collect and remit use taxes to the destination state, requires further exploration to flesh out administrative details and their fiscal implications. I urge, if some sort of further moratorium is to become federal law, that you obligate in such extension legislation that the U.S. Treasury and Joint Committee on Taxation undertake a very serious examination of the sort of alternatives and related details that I have sketched out this afternoon. Such a joint executive-legislative study¹⁰ should be completed by a date certain. Afterwards, I think there should be a significant set of public hearings to discuss the findings also by date certain.

I would be happy to respond to any questions you may have about this testimony or issues related to it.

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¹⁰ Lists of various administrative details that would need to be addressed to simplify state sales and use taxes can be found in both the NTA *Final Report* and the ACEC *Report to Congress*. The NTA *Final Report* contains extensive discussion of most of the problems and options to simplify state sales and use taxes. Hopefully such a federal review would deal more extensively than either *Report* with the problems the states would face in keeping their local governments whole once local sales and use taxes were phased out. It is imaginable, for example, that new federal statistics on the intra-state patterns of local retail sales would have to be collected to enable the states to share back state revenues on an acceptable basis to local governments.