

**MASTERS OF COMPLEXITY AND
BEARERS OF GREAT BURDEN:
THE SALES TAX SYSTEM AND
COMPLIANCE COSTS FOR
MULTISTATE RETAILERS**

By:

Robert J. Cline

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**Ernst & Young Economics Consulting
and Quantitative Analysis**

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*This study is the third in a series prepared for the eCommerce Coalition, a broad-based, national coalition dedicated to providing sound policy information on electronic commerce taxation.

The Coalition members include America Online, Inc., Andersen Consulting LLP, Bank One, Cisco Systems, Inc., Citibank, N.A., First Data Corporation, Intuit, Inc., Microsoft Corporation, Sears Roebuck and Co., Time Warner, Inc., and Wal-Mart Stores, Inc. Inquiries concerning the Coalition should be made to Joseph R. Crosby, Ernst & Young's National Director of State and Local Tax Legislative Services. Mr. Crosby's phone number is 202/327-5817 and his email address is joseph.crosby@ey.com.

The first study in the series is *The Sky Is Not Falling: Why State and Local Revenues Were Not Significantly Impacted by the Internet in 1998*. The second study is *Tariffs and Consumption Taxes: Understanding the Differences*. Both studies can be found at www.ey.com/e-commerce.

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MASTERS OF COMPLEXITY AND BEARERS OF GREAT BURDEN: THE SALES TAX SYSTEM AND COMPLIANCE COSTS FOR MULTISTATE RETAILERS

EXECUTIVE SUMMARY

Overview

Electronic commerce, the purchase of goods and services over the Internet, is raising a fundamental tax policy question: **Does the current state and local sales and use tax collection system still work in an increasingly national consumer market?** The economics of the Internet will greatly expand the number of purchases consumers can make from out-of-state businesses. While this increased flow of cross-border retail sales will provide consumers with increased choices and reduced distribution costs, it will also expose both consumers and retailers, particularly small retailers, to the complexities and high compliance costs built into state and local sales and use tax systems.

Recognizing the potential negative impact of such high compliance costs on the free flow of interstate commerce even before the advent of electronic commerce, the U.S. Supreme Court has strictly limited the legal obligation of out-of-state retailers to collect a sales or use tax on sales to consumers in states other than those in which the retailer actually establishes a business operation. Retailers must have a physical presence in the consumer's home state before the seller is required to collect the tax. Where retailers do not have collection responsibilities, the consumer is responsible for use tax liability. As more interstate retail trade occurs over the Internet and other remote selling channels, both ecommerce businesses and consumers face even higher costs of complying with current sales and use tax laws.

This report discusses the features of the current sales and use tax system that create high compliance costs and presents estimates of the magnitude of these costs. It also identifies the additional compliance costs that face remote sellers, including ecommerce retailers.

Key Findings

State and local sales and use taxes are expensive to administer and the costs are borne primarily by retailers.

The major finding in this study is that the complex system of unique sales and use taxes in 46 different states and almost 7,500 local governments (Table I) imposes a significant compliance cost burden on retailers. Although the consumer is legally obligated to pay the sales or use tax in most states, the tax is collected almost exclusively from retailers with nexus in the taxing jurisdictions.

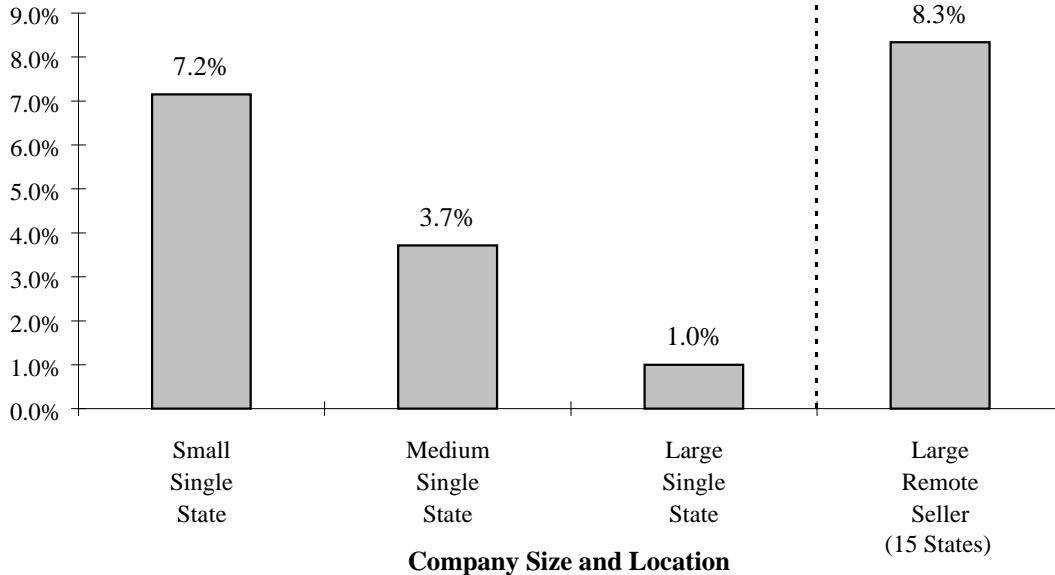
Figure I presents estimates of compliance costs, measured as a percent of sales and use taxes collected, based on the most recent detailed retail study by the State of Washington Department of Revenue.

Table I
State and Local Sales Tax Jurisdictions, 1999

Type of Jurisdiction	Number Imposing Sales Tax
States	46
Local Governments	
Cities	4,696
Counties	1,602
Other Jurisdictions	1,113
Total Jurisdictions	7,458

Source: Authors' estimates.

Figure I
Compliance Costs as a Percent of Sales and Use Taxes Paid



Source: Washington Department of Revenue, *Retailers' Cost of Collecting and Remitting Sales Tax*, December 1998.
Authors' estimates for large multi-state remote seller

These results (in Figure I) indicate that:

- Small in-state retailers (\$250,000 of annual taxable sales in Washington) bear unacceptably high compliance costs – 7 percent of sales taxes collected – that put them at a competitive disadvantage to larger firms in the state. This high level of compliance costs suggests that, for smaller firms, the sales tax may be reaching the point where it cannot be collected at a reasonable cost.
- Medium (\$750,000 of sales) and large retailers (\$10 million in sales) have lower compliance cost burdens because fixed compliance costs are spread over larger sales tax collections and they generally use automated collection and reporting systems. The compliance cost for the medium-size retailer is still very high at almost 4 percent of sales taxes collected, or one-quarter of its profits.

- These high compliance costs result directly from complexities built into each component of the sales tax system: definitions of what is taxable, multiplicity of tax rates, numerous exemptions for specific buyers or uses, overlapping jurisdictions, filing requirements and audit procedures.

Multistate retailers with collection responsibilities in a number of states bear significantly higher compliance burdens than single-state sellers.

State and local governments have proven to be *masters of complexity* in designing their sales tax systems, which impose *great burdens* on multistate retailers.

- As shown in Figure I, we estimate that a large remote seller with collection responsibility and sales in 15 different states incurs compliance costs equal to 8.3 percent of taxes collected, a burden that *exceeds* that for a small, single-state retailer.
- For firms selling nationally with collection responsibilities in all 46 states, the compliance costs range from 14 percent of sales taxes collected for large retailers, to 48 percent for medium retailers, and 87 percent for small retailers.
- Compliance cost drivers affecting multistate retailers include wide variations in what is taxable across states, significant differences in which consumers and what uses are exempt, and many tax base and rate changes passed each year.

In addition to the sales tax compliance costs borne by traditional multistate retailers, ecommerce firms selling over the Internet face additional costs that reflect unique aspects of electronic commerce.

- The uncertainty of the tax status of new products and services, such as electronic copies of computer software and other digital products that are downloaded from the Internet, is a major sales tax problem for ecommerce.
- The Internet has the potential to deliver taxable products to customers without the retailer knowing their location. The current sales and use tax system, in contrast, is a destination-based tax where the location of consumption determines if it is taxable and at what rate. Collecting this information will add compliance costs.
- Ecommerce can deliver bundled products that combine both taxable and non-taxable components, such as telephone service, Internet access and information content. Retailers may incur significant compliance costs in separately identifying the taxable value of the combined transaction.

The key tax policy implication of the results in this report is that fundamental changes in the sales and use tax system are needed to simplify the tax system and reduce the unacceptably high costs of collecting state and local sales taxes in the more competitive, integrated national economy of the 21st Century.

MASTERS OF COMPLEXITY AND BEARERS OF GREAT BURDEN: THE SALES TAX SYSTEM AND COMPLIANCE COSTS FOR MULTISTATE RETAILERS

I. Introduction

The sales and use tax, the single largest source of state and local revenue in the U.S., is a unique tax that imposes the principal costs of collection on third-party retailers, rather than consumers or tax agencies. Because the tax is imposed on each taxable purchase made by consumers, it is a complicated tax that is expensive to collect. Retailers who are obligated to collect the tax from consumers bear significant sales tax compliance costs. This study identifies these costs and discusses the expected effect of electronic commerce, the purchase of goods and services by consumers over the Internet, on sales tax compliance costs.

One of the most significant state and local tax policy issues tied to ecommerce, is how to administer existing sales and use taxes in the case of taxable retail purchases made over the Internet.¹ This is not a new state and local tax policy issue. State and local governments have been dealing with the challenge of collecting retail use taxes from customers of out-of-state catalog and other direct-marketing companies for decades.

The economics of the Internet is, however, greatly expanding the number of businesses, often small in size, that will be selling to consumers in a number of different states. Their customers are subject to state and local sales or use taxes in their state of residence on many of these purchases. In addition, similar to mail order catalog and other remote sellers, ecommerce firms that have a physical presence in a state are responsible for collecting the tax from their customers. Whether to provide assistance to their customers or to comply with collection responsibilities, ecommerce firms, regardless of size, will have to deal with the complex system of state and local sales taxes throughout the U.S.

This study finds that retailers of all sizes incur significant compliance costs in collecting sales and use taxes. The costs are particularly high for multistate retailers given the significant differences in sales tax systems across the states. We also find that there are no quick fixes to deal with this complexity and high level of compliance costs. The solution will require a fundamental restructuring and simplification of sales and use taxes, not a simple change dealing with ecommerce sales in isolation.

¹ The first paper in this series, *The Sky Is Not Falling: Why State and Local Revenues Were Not Significantly Impacted by the Internet in 1998*, June 18, 1999, identifies the consumer Internet retail purchases that are typically subject to state and local sales and use taxes.

II. Issues in Collecting Sales and Use Taxes from Remote Sellers

A key tax policy issue related to sales and use taxation of Internet retail sales is how to collect the tax due on taxable purchases by residents from out-of-state remote sellers. An understanding of how sales and use taxes are collected on in-state and out-of-state purchases is a necessary first step in understanding the tax collection issues related to ecommerce. This discussion begins with an overview of the U.S. Supreme Court's decisions that have defined the legal liability of remote sellers to collect the sales and use tax.

Supreme Court Cases

As a result of the U.S. Supreme Court decisions in *National Bellas Hess v. Department of Revenue of the State of Illinois* (386 U.S. 753, 1967) and *Quill v. North Dakota* (504 U.S. 298, 1992), remote sellers are only liable to collect sales and use taxes if they have the requisite nexus with the buyer's state. "Nexus" means "connection" between the taxing jurisdiction and the business which the jurisdiction seeks to tax. The Supreme Court, in deciding the cases cited above, said that requiring the remote seller to collect and remit sales or use tax in a state in which it did not have physical presence (e.g., employees or property) would be an impermissible burden on interstate commerce and, in the Illinois case, would violate the Due Process Clause of the Constitution of the United States.

In *National Bellas Hess*, the U.S. Supreme Court ruled that a catalog company incorporated in Delaware was not required to collect sales and use taxes for sales in Illinois. The court based their ruling on both the Due Process and Commerce Clauses of the Constitution. The court ruled that the Due Process Clause was violated because Illinois did not have the proper jurisdiction to impose taxes on the seller because the company did not have physical presence in the state.

Moreover, the court ruled that the Commerce Clause was violated because the tax would have imposed substantial compliance costs on the seller that would have impacted interstate commerce. The court noted that:

The many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle National [Bellas Hess]'s interstate business 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."²

The physical presence rule was revisited in *Quill*. Quill Corporation was a catalog sales company without a physical presence in North Dakota. The North Dakota Supreme Court ruled that Quill was required to collect sales taxes because its sales of office furniture to

² U.S. Supreme Court, *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753, CCH Online pages 2-3, May 8, 1967.

in-state customers established an economic presence that created nexus for sales tax purposes.

The U.S. Supreme Court overruled the state court's decision in determining that Quill did not have nexus in North Dakota. However, the court partially reversed *National Bellas Hess* in their decision ruling that, under the Due Process Clause, a state could tax a company based on the economic impact of the business. The Supreme Court affirmed, however, its prior decision in *National Bellas Hess* that for a company to have a duty to collect sales tax under the Commerce Clause, the company must have "substantial" connections with a state (physical presence). The Court noted that many mail-order companies had relied on the prior decisions. Arguably many ecommerce companies are also relying on those same decisions.

Current Law Collection Responsibilities

Constrained by the U.S. Supreme Court's decisions, the current system of sales and use taxation imposes different collection responsibilities on buyers and sellers depending on where the seller is located and whether the buyer is a consumer or a business. Table 1 summarizes these sales and use tax collection responsibilities.

For retail sales by an in-state seller to consumers in the same state, the sales tax is imposed on the consumer, but collected by the seller who remits taxes to the tax agencies. For sales to consumers by an out-of-state seller, the seller is only liable to collect a sales tax from the consumer if the seller has sufficient nexus or connection with the consumer's state to require collection. The sales tax collected by out-of-state sellers is termed a use tax in most states. If the seller does not have liability to collect the use tax, the buyer is legally obligated to pay a self-assessed use tax directly to their state and local governments.

Businesses are also taxable under the sales tax on a significant portion of their purchases, including office furniture, supplies, and computer equipment and software not used in the manufacturing process.³ The largest business taxpayers in most sales tax states have permits to buy taxable inputs without paying a sales tax to the seller. Instead, they file tax returns directly with tax agencies and pay a self-assessed use tax on their taxable purchases.

Table 1 shows that there are three situations where sellers are not required to collect sales taxes on taxable purchases by buyers (consumers or firms): 1) consumer purchases from remote sellers without sales tax nexus in the buyer's state; 2) business purchases from remote sellers without nexus; and 3) businesses purchases from in-state or remote sellers that are exempt at the time of sale, including purchases by direct pay permit holders. In all three cases, the buyer is legally obligated to pay the sales or use tax.

³ Raymond J. Ring, Jr., "Consumers' Share and Producers' Share of the General Sales Tax", *National Tax Journal*, March 1999, pp. 79-90, estimates that the producers' share of the general sales tax was 41 percent of all sales taxes in 1989.

Table 1
Responsibilities for Collecting Sales and Use Taxes

Location of Buyer	In-State Seller	Out-of-State Seller
A. Consumers		
In-state	Seller collects sales tax	With nexus: seller collects a use tax for the home state Without nexus: seller does not have liability to collect tax; instead, consumer is responsible for paying use tax directly to home state
Out-of-state	No sales tax collected by the seller if the good is shipped to a state where the in-state seller does not have nexus	Not applicable
B. Businesses		
In-state	Seller collects the tax on taxable sales to most business purchasers Business purchasers, including direct pay permit holders, may pay a use tax directly to tax agencies	With nexus: seller collects a use tax for the home state (unless the business pays use tax directly) Without nexus: no sales tax collected by seller; business purchaser pays a use tax to home state
Out-of-state	No sales tax collected by the seller if the good is shipped to a state where the in-state seller does not have nexus or if the tax directly paid	Not applicable

Alternatives for Increasing Sales Tax Compliance Under Current Law

While current law is clear on who has the legal responsibility to collect or pay sales and use taxes, state and local governments are questioning the system's effectiveness in collecting sales and use taxes on their citizens' purchases from remote sellers. Government's concern is focused on remote sales where out-of-state sellers do not have nexus to collect the use tax from in-state residents or businesses. In these situations, consumers and businesses owe a use tax, but noncompliance is a significant problem for consumer purchases.

States already have extensive sales and use tax audit activities designed to ensure compliance by business purchasers with sales and use tax laws. There is, in contrast, little effort by government to ensure consumer use tax payments on remote purchases where a seller does not collect a tax from consumers.

Several alternatives for increasing consumer sales tax compliance under existing laws are being used by selected states. They include:

1. Increasing state and local government efforts to encourage voluntary sales tax compliance under the current self-assessment system for consumer purchases from remote sellers;
2. Strengthening use tax audit and enforcement activities through the use of information reporting by remote sellers or information exchanges among tax agencies; and
3. Encouraging voluntary collection of consumer use tax by remote sellers without nexus in a state.

Increasing Voluntary Consumer Compliance

Because the use tax is collected after a retail sale takes place, collection depends upon the voluntary compliance of consumers, as well as the enforcement activities of tax agencies. The low level of use tax compliance suggests that consumers are not aware of their use tax liabilities, do not voluntarily comply with the law, or that the enforcement efforts of taxing jurisdictions are low, ineffective, or nonexistent. It is apparent that taxpayers need additional information and assistance to comply with the current consumer use tax laws.

Even if consumers know that a use tax liability exists, payment of the tax may not be straightforward or convenient. In Iowa, for example, the consumer's use tax brochure provides the following instructions:

Use tax applies to, but is not limited to, purchases made tax free through mail-order catalogs, television shopping programs, and toll-free 800 numbers; magazine subscriptions; and untaxed purchases made while in another state and shipped or otherwise brought into Iowa. Anyone – individuals and businesses – who makes these types of purchases is required to pay consumer's use tax to the Iowa Department of Revenue and Finance.

Persons who owe consumer's use tax should send a check payable to Treasurer State of Iowa with a note explaining that it is for consumer's use tax and listing the items purchased and the purchase price of those items.⁴

⁴ The Iowa brochure also explains why all out-of-state businesses do not collect the use tax. Only sellers with a physical presence in Iowa, such as a store, warehouse, or sales staff, are required by law to register

One option to increase voluntary compliance is for states to more effectively enforce current use tax laws. For example, states can include use tax forms and instructions with individual income tax returns to encourage consumers to report sales and pay taxes on remote sales. Or states can include a line directly on the income tax form to be used to report use taxes.

Maine is an example of a state that has encouraged voluntary use tax compliance by consumers by linking the use tax directly to the income tax form. All taxpayers have to report the amount of use tax they owe on purchases from sellers that did not collect a sales tax (out-of-state sellers, for example). In 1998, 15 percent of individual income tax filers reported use tax totaling \$1.5 million.⁵ Taxpayers had the option of reporting the actual amount of use tax paid or an alternative amount equal to 0.0004 times their adjusted gross income, a use tax of \$14 for a family with \$35,000 of income and equivalent to \$255 of taxable out-of-state purchases.

Maine's compliance with the use tax law was partly due to the fact that the state tax department imputed a use tax liability (using 0.0004 times adjusted gross income) on any return without an entry on the use tax line. The Maine legislature, however, in response to taxpayer opposition, eliminated this requirement in 1999.

The Connecticut income tax return contains a line specifically for reporting individual use tax. The instructions state: "You must enter a zero on this line if no use tax is due, otherwise you will not be considered to have filed a use tax return." New Jersey also has a use tax line on the tax form. In 1997, only 11,300 returns, less than 1 percent of all returns, reported use taxes of \$688,000.⁶ Virginia added a use tax line to the income tax return in 1998 that replaced a separate use tax form. To reduce compliance costs for consumers, Virginia only requires reporting of use tax if taxable purchases on which sales tax was not collected exceed \$100 a year. The majority of states, however, do not ask for the consumer use tax on the income tax return itself and require separate direct reporting to the state.

Information Exchanges

Another possibility for increasing compliance with the use tax is for state tax agencies to establish tax compacts or cooperative enforcement agreements with other states to share information about sales to consumers in other states that is produced in the process of auditing in-state retailers. For example, twelve Southeastern states have a cooperative agreement that publicizes use tax obligations, encourages voluntary registration to collect use taxes and shares audit information.

and collect sales tax. Firms without a physical presence, such as mail-order companies, are not required to collect a use tax even if they actively solicit instate orders.

⁵Based on information from Maine Revenue Services. The \$1.5 million of reported use taxes was roughly 4 percent of total state sales tax collections.

⁶Based on information from the New Jersey Division of Taxation. Total sales and use tax collections in New Jersey in 1997 were \$4.4 billion.

Voluntary Shifting of Collection Responsibilities to Remote Sellers

As discussed earlier, remote sellers who do not have physical presence in a state are not liable for collecting a use tax on sales to consumers in the state. However, some states are encouraging out-of-state businesses without nexus to register and collect the sales or use tax voluntarily. Iowa has pursued this option with some success with out-of-state catalog retailers. The Iowa Department of Revenue and Finance has worked with several remote sellers to establish voluntary agreements that reduce compliance risks and costs associated with collecting the use tax.

Sellers may register voluntarily to reduce the compliance burdens for their customers who are legally liable to pay the tax. To the extent that out-of-state sellers volunteer to collect the tax, this will add to the sales and use tax collections already being submitted by remote sellers that have a physical presence in a state.

III. Sales Tax Compliance Costs Borne by Sellers

The sales tax system in the United States is a collection of 46 state and almost 7,500 local taxes that differ significantly in what is taxable, at what rate, and how they are administered. For the 31 states that permit local governments to impose a sales tax (see Table 2), there is often wide variation in bases and rates within a state. This complexity makes it costly for retailers, whether doing business only in one state or in multiple states, to comply with the sales and use tax laws and for tax agencies to administer the law.

This section looks at the main tax features causing the relatively high compliance costs for all retailers and identifies additional complexities that create new compliance costs for ecommerce retailers.

A. Compliance Issues Facing All Retail Sellers

Retailers that have nexus for collecting retail sales and use taxes have to identify where consumers live, what purchases are taxable and at what rates in each location, file periodic returns to each state and local government, and comply with all audit requirements in each jurisdiction. The following discussion focuses on two major features of the sales and use tax system contributing to high compliance costs: variations in tax bases across jurisdictions and complexities associated with almost 7,500 local sales taxes.

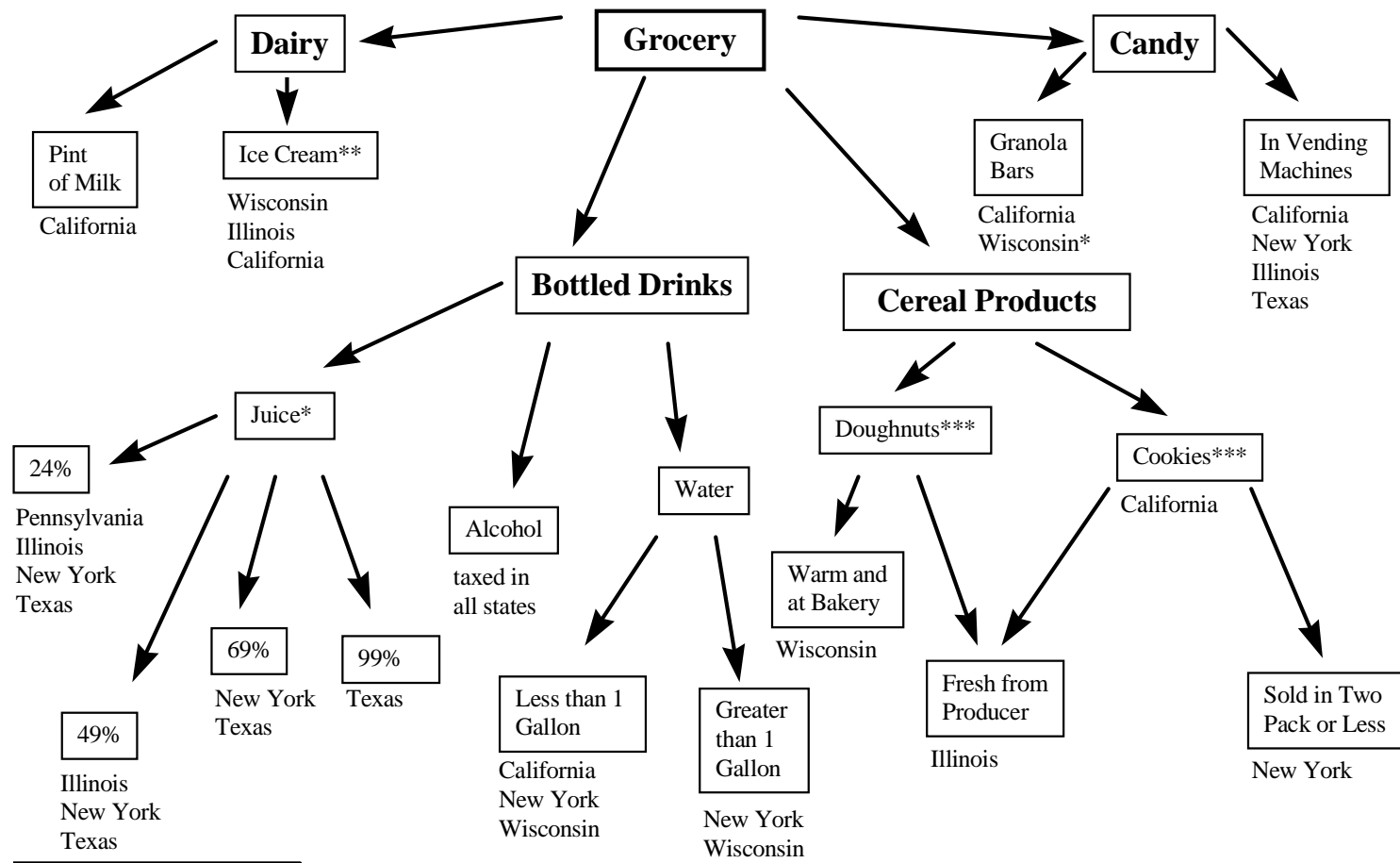
Defining the Tax Base

There is tremendous variation across the country and within individual states in the goods and services subject to the retail sales tax. One reason for this variation is the absence of a national sales tax that could provide a standard tax base; in the case of the income tax, most states piggyback on the federal definition of taxable income. More importantly, the variation comes from the fundamental fact that the tax is a transaction tax that can be adjusted to include an almost infinite combination of goods and services in the tax base. Each state, and in many cases each legislature within a state, has a different view of the appropriate tax base. This explains why states differ in the definition of the tax base and why states' tax bases change continually over time.

Figures 1 and 2 provide a few of the many possible illustrations of how much variation there is in what is taxable in different states. The examples illustrate important differences in taxation of food and clothing for only a few of the 46 sales tax states.

Many states exempt food or grocery items from the sales tax, but have complex definitions of what is exempted. Wisconsin does not exempt “candy” (which includes some granola bars and candied apples), any beverage that is not 100% juice, and food for research; it does exempt cookies. Although many states exempt ice cream as a milk product, Wisconsin taxes ice cream as a form of candy. Juice has perhaps the most

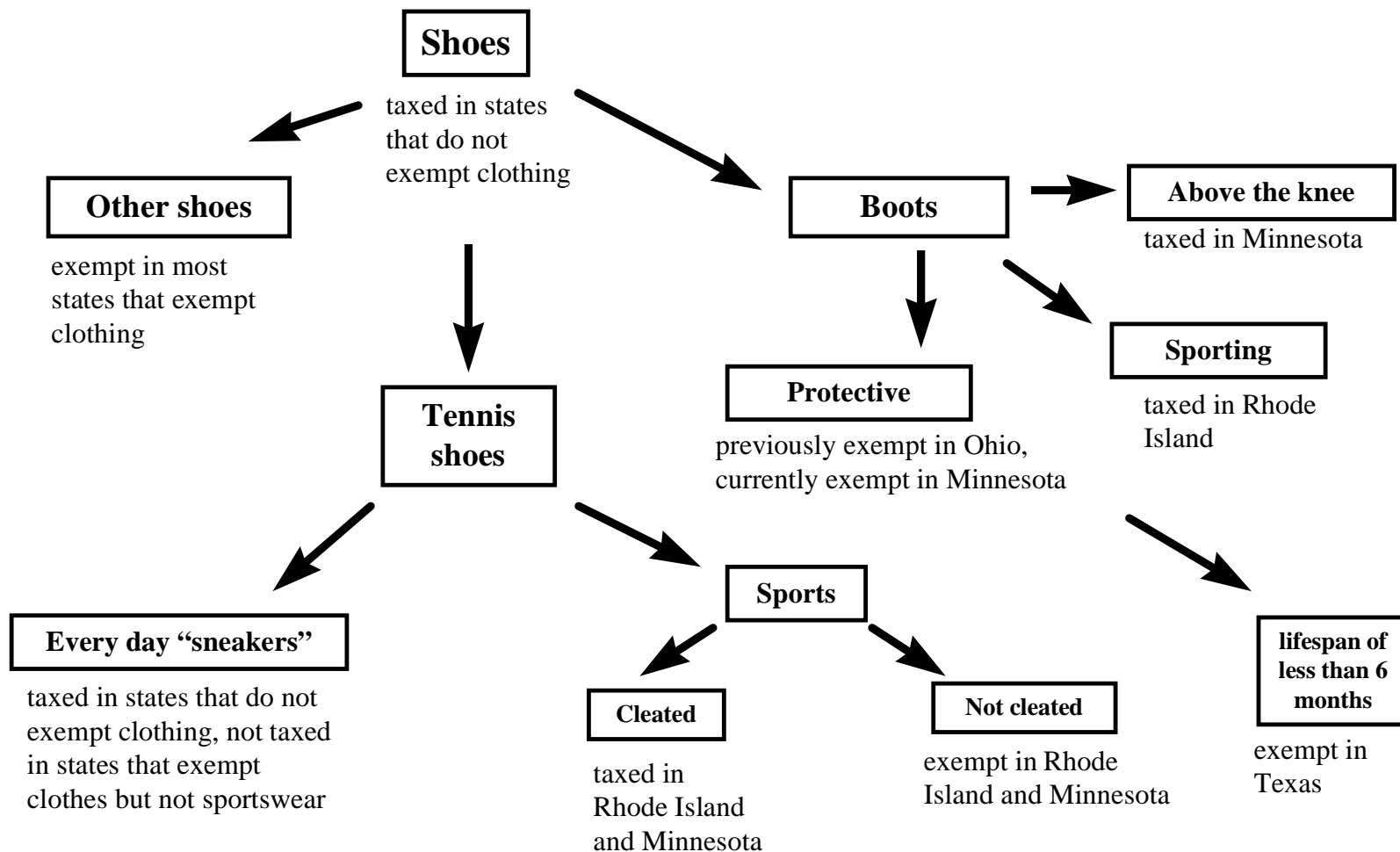
Figure 1
Sales Tax Treatment of Grocery Items in Six Selected States



* Wisconsin taxes juice when the label uses the words cocktail, drink, punch, ade or nectar. Granola Bars are taxable in WI only if coated with candy or yogurt coating
 ** For immediate consumption in a restaurant or parlor.
 *** Doughnuts and cookies are taxed in Pennsylvania if they are sold at a carnival

Key: States that apply sales tax on the item are listed, otherwise the selected states exempt that product.

Figure 2
Examples of Sales Tax Treatment of Shoes in Selected States



varied tax treatment of all grocery products. While Pennsylvania taxes juice if it has less than 24% real fruit juice, Texas requires at least 99% real fruit juice to be exempt.

Just as grocery items have a variety of tax treatments, so do articles of clothing. Examples of the treatment of shoes is illustrated in Figure 2. Everyday “sneakers” are taxed in states that do not exempt clothing. Six states exempt clothing but not athletic wear. Sports shoes may be considered as athletic wear or everyday sneakers depending on their use. In Rhode Island and Minnesota, shoes with cleats are taxed, but sports shoes without cleats are exempt. Above the knee boots are taxed in Minnesota, and Texas does not exempt clothing but exempts protective boots with a life-span of less than six months.

Vendors that sell food and clothing in multiple states, as well as to in-state consumers, need to understand the retail sales tax treatment of all of these items in each state to comply with their legal collection responsibilities. If they do not collect the correct tax, they could be subject to penalties and interest, as well as being liable for the uncollected tax.

Hitting a Moving Target

State legislatures make substantial changes in the definition of what is taxable under the sales tax every legislative session. Annual tax bills often contain dozens of changes in sales tax law provisions that create new exemptions from the base, establish new exempt uses, or create new categories of exempt purchasers. Retailers incur additional compliance costs each year to handle these tax base changes.

Recently three states (New York, Florida and Texas) have provided sales tax “holidays” for certain categories of shoes and clothing that change the definition of what is taxable on certain days of the year. These temporary changes further complicate the law and increase already high compliance costs for retailers. The length of the exemption period varies from three to nine days. Texas allows for a tax holiday for three days in August; Florida allows for a nine-day tax holiday in August, and New York offers tax breaks during one week in September and one week in January.

Aside from the length and timing of the tax break, the items that are exempt differ across states, and the dollar amount of exempt clothing also differs. Texas exempts most clothing and footwear, but not sportswear,⁷ accessories, and a few other items. Furthermore, only clothing items that cost less than \$100 per piece are exempt from the sales tax. The threshold at which a clothing unit is taxable in New York is quite large, at \$500. In Texas and Florida the tax holiday extends to local sales taxes, but in future years local governments have the option to participate. New York, on the other hand, is even more confusing, allowing certain cities and counties to choose not to participate in the sales tax holiday.

⁷ Sportswear and clothing also have different definitions in Texas and Florida, complicating the tax holiday even more.

While popular with consumers and legislators, the tax holidays provide another example of the challenges to retailers and consumers in complying with the law.⁸ For certain days of the year, the definitions of what is taxable change substantially, but temporarily. These changes impose significant new compliance costs on all retailers. In addition, remote sellers are confronted with difficult issues of timing that can increase compliance costs. For example, does the holiday period apply to the date when a product is ordered or delivered?

Retailers are not compensated for the additional compliance costs created by these sales tax holidays. In responding to questions from retailers, the Florida Department of Revenue noted that the tax holiday legislation provides no funding for retailers' added costs of compliance, nor is there any additional vendor discount allowed because the legislature anticipated that additional sales would pay for the added compliance costs.⁹ It becomes increasingly more difficult to ensure full sales and use tax compliance of consumers and retailers with the introduction of this type of increased complexity into the sales tax system.

Multiple Local Sales Tax Jurisdictions

In addition to each of the 46 separate state and local tax systems, remote sellers must comply with separate and unique sales and use tax systems in almost 7,500 cities, counties, and other local jurisdictions across the U.S. As shown in Table 2, there are over 1,300 separate sales tax jurisdictions in Texas alone. In all but eight of the 31 states with local sales taxes, the tax is used by more than one type of local government. Note that while these figures represent the units of government imposing sales and use taxes today, there is potentially a much larger problem if every unit of local government that exists chose to impose a sales and use tax. According to the *Statistical Abstract of the United States, 1998*, the number of units of local government that existed in the United States in 1997 was 87,453 (3,043 counties, 19,372 cities, 16,629 townships, 13,726 school districts, and 34,683 special districts).

The complexities and compliance costs that are added by local sales taxes goes far beyond the multiplicity of rates. Local governments in many states have different definitions of what is taxable and what exemptions are provided. In addition, they often treat cross-border sales and transportation charges differently from the state tax. Seven states also require multistate retailers to file separate tax returns in local jurisdictions (examples include Alabama, Arizona, Colorado, Louisiana and Minnesota). Another complicating feature is that taxpayers may be required to file returns more frequently, weekly for example, in some jurisdictions than in others.

⁸ It is virtually impossible for a retailer to determine what is or is not taxable during the tax holiday. This was made clear by the Texas State Comptroller's message to retailers that stated the following: "We could not put every possible item that qualifies for the exemption on the list, so please call my office if you have any questions about other items. After this year's tax holiday we will revise the rule and list to address questions that come up during the first holiday." (<http://www.window.state.tx.us/taxinfo/holiday>)

⁹ State of Florida, Department of Revenue, *1999 Tax Relief Act, Questions and Answers*.

B. Unique Compliance Issues for Ecommerce Remote Sellers

The economics of ecommerce is creating a rapidly growing number of sellers, often relatively small, that could bear compliance costs experienced by other, multistate remote sellers, if they have nexus to collect use taxes. Ecommerce firms, however, could face additional compliance costs due to unique features of ecommerce, including:

- Paperless transactions;
- Anonymous ecash transactions;
- Lack of details on location of buyers;
- Electronic delivery of goods (computer software and CDs, for example); and
- Bundling of taxable and non-taxable goods and services, such as access, information and taxable goods, and non-taxable services.

These unique ecommerce features are raising critical sales tax compliance issues for firms selling over the Internet to customers in states where they have physical presence. The fact that retailers selling over the Internet are very likely to be selling into a large number of jurisdictions where they have no physical presence could also create significant compliance cost burdens without the protection of *Quill* against the duty to collect. From a tax policy perspective, states will have to deal with the impact of these ecommerce features on the sales tax system independently of the traditional remote seller issue.

The Internet has altered the form in which goods and services are transferred to consumers (e.g., software and stock brokerages). This may also change the tax treatment of goods and services. Goods taxable as tangible items may not be taxable in digital form. The bundling of goods and services blurs the distinction between taxable and exempt products. New innovations in payment methods are also changing the economic landscape. Anonymity of the consumer is increased and the possibility for tax avoidance by consumers becomes greater. As retail purchases over the Internet increase, these issues will add to the complexity and compliance costs of the sales tax system.

Electronic Money

Electronic money (ecash) is a new medium of exchange where a computer chip imbedded in a plastic card may be scanned by a computer to make purchases. Unlike a debit card, the chip stores the remaining balance itself rather than having to go through a third party. Like traditional currency, ecash purchases generally are anonymous and make it difficult to track the point of sale. It is expected that ecash will, in the near future, be transferred over the Internet and downloaded to personal computers to be used to pay for ecommerce transactions.

Table 2
Number of Taxing Jurisdictions for Sales and Use Tax, 1999

State	State Tax	Cities	Counties	Other	Total
Alabama	1	415	79	320	815
Alaska	--	98	--	--	98
Arizona	1	86	14	--	101
Arkansas	1	192	69	--	262
California	1	4	58	44	107
Colorado	1	201	42	7	251
Connecticut	1	--	--	--	1
District of Columbia	1	--	--	--	1
Florida	1	--	44	1	46
Georgia	1	--	159	--	161
Hawaii	1	--	--	--	1
Idaho	1	3	--	--	4
Illinois	1	100	8	3	112
Indiana	1	--	--	--	1
Iowa	1	--	6	586	593
Kansas	1	142	69	--	212
Kentucky	1	--	--	--	1
Louisiana	1	203	63	74	341
Maine	1	--	--	--	1
Maryland	1	--	--	--	1
Massachusetts	1	--	--	--	1
Michigan	1	--	--	--	1
Minnesota	1	9	87	--	97
Mississippi	1	--	--	--	1
Missouri	1	580	107	--	688
Nebraska	1	64	--	--	65
Nevada	1	--	9	--	10
New Jersey	1	--	--	--	1
New Mexico	1	106	33	--	140
New York	1	22	56	1	80
North Carolina	1	--	100	--	101
North Dakota	1	65	--	--	66
Ohio	1	--	88	4	93
Oklahoma	1	481	49	--	531
Pennsylvania	1	--	--	--	1
Rhode Island	1	--	--	--	1
South Carolina	1	--	16	--	17
South Dakota	1	186	--	4	191
Tennessee	1	9	95	--	105
Texas	1	1,193	118	45	1,357
Utah	1	227	29	3	260
Vermont	1	--	--	--	1
Virginia	1	41	95	--	137
Washington	1	269	39	21	330
West Virginia	1	--	--	--	1
Wisconsin	1	--	47	--	48
Wyoming	1	--	23	--	24
United States Total	46	4,696	1,602	1,113	7,458

Note: Alaska, Delaware, Montana, New Hampshire, Oregon; States without a sales tax

Source: Authors' estimates.

The fact that the use of ecash can facilitate anonymous retail transactions creates problems for remote retailers with sales tax collection responsibilities in multiple states. As noted below, ecash makes it more difficult for sellers to identify the resident state for determining sales taxes.

Digital Products

Digital products have revolutionized the way companies do business and, with the help of the Internet, digital products are also revolutionizing the way certain goods may be purchased and delivered. The Internet allows software, music and books to be downloaded directly to a computer rather than purchased from a store or delivered by common carrier. This makes it nearly impossible for the seller to identify the destination where the products are consumed. If sellers cannot determine the jurisdiction where consumption occurs, they will not be able to determine if they have a sales and use tax collection responsibility, or, even if they do, what rate to apply.

Digital products are also raising difficult, and often unanswered questions about, the tax status of the products. This is an important source of complexity that is unique to Internet sales of digital products. For example, is a copy of a computer software program downloaded from the Internet a taxable tangible product, a non-taxable service or an intangible product that is undefined in sales tax law? Or, does a newspaper delivered over the Internet receive the same exemption from sales tax that is provided in many states to a newspaper published or printed in written form?

Every state will have to clarify the tax treatment of the wide range of digital products that can be delivered over the Internet, but there appears to be wide disagreement among states on how these transactions should be taxed.

Anonymous Transactions

Anonymity of both the buyer and the seller will add to sales tax compliance costs. Electronic commerce allows businesses to sell to a global audience but it also requires that, given nexus, businesses must properly calculate sales tax. A seller will not be able to determine their liability for collecting a use tax (if any), the tax status of the transaction or the applicable tax rate if they cannot identify the location of the consumer.

C. What Are the Compliance Cost Drivers?

The costs of complying with state and local retail sales and use tax systems can be significant, especially for small to medium-size retailers. Ecommerce generally faces the same set of compliance costs as other multistate sellers, but the costs for selected categories may differ because of the economic characteristics of ecommerce.

Seller activities that generate compliance costs include:

- Sales tax registration;
- Identification of consumer residence;
- Defining what is taxable;
- Determining applicable tax rates;
- Identifying purchaser or product exemptions;
- Unbundling taxable and non-taxable transactions;
- Calculating net tax amounts;
- Updating for changes in rates and bases;
- Filing returns; and
- Audit activities and post-sale collection of underreported taxes.

Sales and Use Tax Compliance Cost Estimates

Because states differ greatly in the structure, level and administration of their sales and use taxes, there are no comprehensive nationwide studies of compliance costs on retailers. There are, however, a few studies looking at sales tax compliance costs in several states that can be used to illustrate sales tax compliance burdens.

State of Washington Department of Revenue Compliance Study

The most detailed and current study available on retailer sales and use tax compliance costs was recently published by the Washington Department of Revenue.¹⁰ Although the study is specific to Washington, it provides important information on the actual costs of complying with state and local taxes for one state and local tax system and how these costs vary by seller size.

The Department of Revenue (DOR) sent a detailed compliance cost survey to 3,400 Washington and Oregon retailers.¹¹ The survey results were reported by three different gross sales size classes: small (\$150,000 to \$400,000 of Washington sales), medium (\$400,000 to \$1,500,000 in sales), and large (\$1,500,000 and over) businesses.

The retailers were asked to supply detailed information regarding all costs of compliance, including processing costs and employee hours dedicated to sales and use tax compliance. The businesses were also asked to determine the percentage of sales paid for by credit

¹⁰ Washington State Department of Revenue, *Retailers' Cost of Collecting and Remitting Sales Tax*, December 1998. Copies of the report may be downloaded at the Department of Revenue home page <http://dor.wa.gov/>.

¹¹ Businesses included in the survey were those classified in Standard Industrial Classification codes 52-59 with at least 50 percent of their Business and Occupation Tax activity in retailing. The types of businesses included: Building Materials & Garden Supplies; General Merchandise Stores; Food Stores; Automotive Dealers & Service Stations; Apparel and Accessory Stores; Furniture and Home Furnishings Stores; Eating and Drinking Places; Miscellaneous Retail (includes catalog and mail-order companies).

cards, debit cards, cash and checks. Questions on the amount of time and money spent on training employees and updating point-of-sale equipment were also included in the survey.

Table 3 shows the results of the Washington compliance cost study for a small (\$250,000 of taxable sales), medium (\$750,000 of sales), and large (\$10 million of sales) retailer. The estimates represent averages for each of the three size classes reported in the study. The table shows that small retailers have significantly higher annual costs, as a percentage of sales tax collected (7.2 percent), than medium-size retailers (3.7 percent) and large retailers (1.0 percent). In dollars, the annual costs for these representative retailers are \$1,286, \$1,931 and \$6,801 for the small, medium and large retailers, respectively.

The compliance cost ratios for small and medium retailers are quite high. To put these cost ratios in perspective, tax agency costs of administering the sales tax system are probably no more than one percent of taxes collected.¹² An administrative cost ratio of 4 to 7 percent of tax collections would not be acceptable from a state budget perspective. This comparison shows the uniqueness of the sales tax system in imposing most of the costs of sales tax administration and compliance on third-party tax collectors.

As shown in Table 3 and Figure 3, the largest categories of compliance costs are return filing costs, point-of-sales costs of additional equipment, customer service and training, and the costs to retailers of paying credit card fees on sales taxes included in the amount charged by customers. Medium and large retailers, using more efficient automated processes and benefiting from the ability to spread fixed costs over larger sales bases, have lower compliance costs than a small retailer. Other compliance costs include storage costs for financial records, costs of mistakes (including retailers' payments of tax not collected from buyers), and costs to change the programming of point-of-service equipment for frequent tax rate and base changes.¹³

As a second part of the compliance study, the Washington Department of Revenue also conducted focus group discussions. Compliance issues of concern identified by retailers were: 1) the paperwork and time resources needed to determine exemptions, 2) large costs associated with record-keeping and audit activities, and 3) possible loss of sales to competitors not collecting and remitting sales tax.

¹² John F. Due and John L. Mikesell, *Sales Taxation: State and Local Structure and Administration*, 2nd Edition, The Urban Institute, Washington, D.C., p. 325.

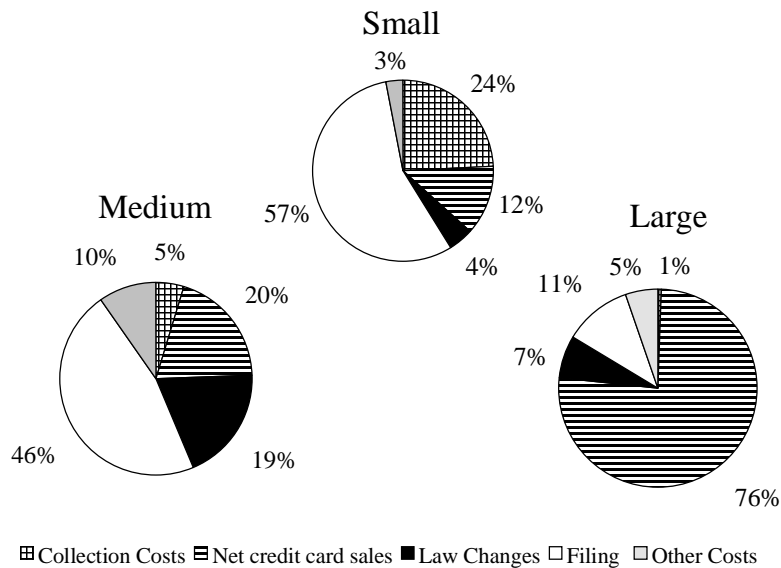
¹³ The compliance cost figures in Table 3 do not include audit-related costs or potential benefits to sellers from any float for the period of time between collecting cash payments of the tax from customers and remittance to tax agencies. It should also be noted that even without credit card fee costs, the cost category that varies most closely with the amount of sales tax collected, compliance costs for the small and medium firms would still be 6.3 and 3.0 percent, respectively, of sales taxes collected.

Table 3
Average Annual Cost of Sales Tax Compliance

	Small Firm	Medium Firm	Large Firm
Point of Sale Collection	\$313	\$94	\$41
Rate Changes	\$41	\$296	\$408
Base Changes	\$16	\$78	\$68
Credit Card Fees	\$160	\$385	\$5,168
Filing Cost	\$720	\$912	\$756
Cost of Mistakes	\$31	\$156	\$340
Record Storage Costs	\$5	\$10	\$20
Total Compliance Costs	\$1,287	\$1,931	\$6,801
Sales Taxes Collected	\$18,000	\$52,000	\$680,000
Cost as a Percent of Taxes Collected	7.2%	3.7%	1.0%

Source: *Retailers Cost of Collecting and Remitting Sales Tax*, Washington Department of Revenue, December 1998; Authors' calculations.

Figure 3
Percentage Distribution of Compliance Costs by Retailer Size



Virginia Study

Although outdated, a study done by the University of Virginia, found similar compliance cost burdens for Virginia retailers.¹⁴ Using time studies plus detailed accounting information from over 130 retailers in five business categories, the study found that compliance costs averaged 6 percent of sales taxes collected in 1976.

The study found that an important cost driver was the need for retailers to verify the tax exempt status of buyers and to separate out their purchases into taxable and exempt product categories. This process involved a time-consuming system of exempt certificates that had to be kept on file by the retailer and updated periodically.

¹⁴ *Cost of Collecting Virginia Sales and Use Taxes*, Eleanor G. May, University of Virginia, Colgate Darden Graduate School of Business Administration, December 1976.

IV. Sales Tax Compliance Costs for Multistate Remote Sellers

The sales tax compliance costs reported in Table 3 are measures of the costs of complying with a single state's sales tax system. For multistate and remote sellers with physical nexus to collect a use tax for their consumers in a number of states, sales and use tax compliance costs are significantly higher. The higher costs include determining the location and exemption of consumers, identifying taxable purchases and tax rates, filing returns in multiple jurisdictions and complying with record-keeping and audit procedures.

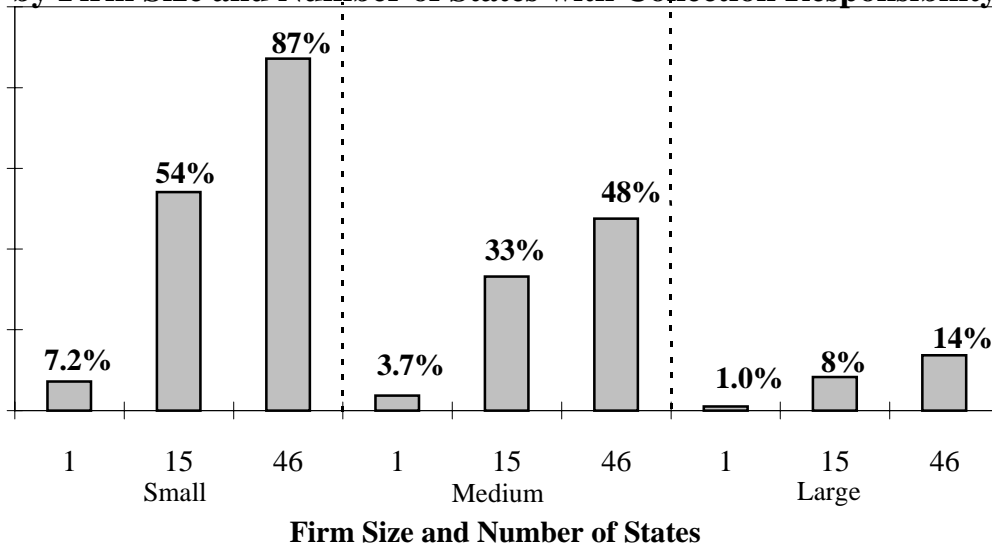
The compliance cost information for the firms in Washington can be used to develop a comparison of the cost of complying with retail sales taxes in multiple states with the costs for a single state. For multistate sellers that have nexus to collect taxes in a number of states, it becomes economically feasible to use commercially available software packages or tax service providers to determine jurisdiction-by-jurisdiction tax rates and bases for each transaction and to prepare and submit state and local tax returns. An estimate of the annualized cost of using software or outside services was added to selected compliance cost information from retailers in the Washington study to estimate the compliance costs of multistate sellers.¹⁵

We estimate that a large remote seller with physical nexus in 15 different states incurs compliance costs equal to 8.3 percent of taxes collected, a compliance burden that actually exceeds the small in-state retailer and far exceeds the burden on the same large size firm selling in only one state (1.0 percent). In effect, the increased costs of complying with 15 different state and local tax systems more than offset the reduction in the compliance ratio expected from the higher gross sales and sales tax collections from the seller's multistate expansion.

Figure 4 summarizes our estimated compliance costs, as a percent of taxes collected and remitted, for small, medium and large retailers operating in 15 states and in all 46 sales tax states. The purpose of this comparison is to illustrate the relatively heavy compliance cost burdens that remote sellers, regardless of size, may face if they have responsibility to collect sales and use taxes in each of 15 or 46 states.

¹⁵ In deriving the estimates of compliance costs for multistate firms, we introduced automation of the tax rate determination and tax return filing processes when costs of manual procedures, as reflected in the Washington study, exceeded our independent estimate of the computer software and related costs of an automated system.

Figure 4
Compliance Costs as a Percent of Sales and Use Taxes Collected,
by Firm Size and Number of States with Collection Responsibility



Source: Authors' calculations.

The height of the bars represents our estimated compliance costs, as a percent of taxes collected, for the different size firms selling in only one state or operating as remote sellers in 15 or 46 states, assuming tax nexus in each state. Within each firm size, the bars show the increasing ratio of compliance costs to taxes collected. For example, compliance costs for the medium-size firm rise sharply from 3.7 to 33 percent of taxes going from selling in one state to selling in 15 states. The costs jump to 48 percent of taxes collected if the firm is responsible for collecting taxes in all 46 states with a sales tax.

Figure 4 also shows the very high compliance cost burdens on the small firm (\$250,000 of annual sales) whether selling in one state or multiple states. We estimate that the small firm selling into and collecting tax in all sales tax states would see compliance costs approaching 90 percent of the taxes remitted to state and local governments. While these compliance cost figures should be viewed as estimates for representative firms, they provide important insight into the additional or marginal costs of complying with the current state and local sales and use tax systems for retailers having nexus in a large number of states.

The compliance cost burdens on multistate sellers can be put into perspective by comparing sales tax compliance costs, as a percent of total sales, to an estimate of the average profitability of retailers. Using information from federal corporate income tax returns, we estimate that retail profits for the medium size firm used in this study average one percent of sales. Based on this profit figure, the compliance costs for the medium firm in one state are equal to 25 percent of the retailer's profits. Compliance costs for the medium firm selling into and collecting sales taxes in 15 states is more than double the

estimated profits and the compliance costs of operating in 46 states is over three times profits.

Above average compliance costs could reduce multistate retailers profitability, thereby discouraging entry into jurisdictions asserting collection responsibility-- holding all else constant. A small or medium sized retailer has to factor in sales tax compliance costs when considering expanding nationally beyond one state.

Compensating Retailers for Compliance Costs

Recognizing the high level of sales tax compliance costs borne by retail businesses, a number of states compensate sellers for a portion of the costs of collecting sales taxes from consumers. Reimbursement is provided in the form of a vendor discount, usually a percentage of sales tax collections.¹⁶

The Vendor Discount table located in the Appendix to this study describes the structure of vendor discounts in each state, along with the state sales tax rate. Twenty-seven states currently offer vendor discounts, typically a percentage of sales taxes collected and often with a maximum dollar amount. Discount formulas also include maximum or minimum amounts in a number of states. Furthermore, many states use a tiered discount system, with the discount rate falling as sales increase. Only six states use a single discount rate.

Six states have a discount rate of at least 3 percent with the highest rate being 5 percent in Alabama's first tier. Arizona allows the largest dollar amount of vendor discount at a rate of 3.3% with no dollar limit. Aside from the 18 states that do not allow vendor discounts, Florida allows the smallest discount amount with a \$30 per report maximum allowance.

These vendor discounts are relatively small compared to the estimated retailer's costs of collecting sales and use taxes. For a retailer with \$52,000 of annual taxes, for example, the vendor compensation in Virginia, one of the most generous states, would be \$96. Using an estimate of annual compliance costs for this size retailer of \$1,931 (see Table 3), the discount is only 5 percent of collection costs. In Texas the discount would cover less than one percent of this retailer's compliance costs. In Washington or California, there is no discount at all.

¹⁶ Retailers and other businesses also bear substantial costs of complying with sales and use taxes on their own purchases of goods and services that are subject to tax. In the case of large firms, they tend to pay the tax in the form of a self-assessed use tax on their purchases. Because of the unique nature of the sales tax, large retailers may face both types of compliance costs: the costs of collecting and remitting sales tax for retail consumers and the cost of paying the tax on their own purchases.

V. What Can Be Done to Simplify the Tax System and Reduce Compliance Costs?

The complexity of the current sales and use tax system, along with the unique collection obligation imposed upon third-party retailers, creates significant compliance burdens for retail sellers and consumers. In addition, ecommerce is adding further complexity and creating a fast-growing number of small firms selling in multiple states (but without physical presence in each state) that could face very high sales and use tax compliance burdens without *Quill* protection. As a result, there is renewed public- and private-sector interest in exploring options for reimbursing sellers for costs associated with simplifying the tax system and reducing compliance cost burdens for retailers and consumers.

Several organizations and groups of taxpayers and government representatives, such as the Communications and Electronic Commerce Tax Project sponsored by the National Tax Association (NTA), have been examining alternative approaches to simplifying the sales and use tax system. A number of suggestions for simplifying the sales tax system and reducing compliance costs have been identified in this process.

Uniform Definitions of Taxable Goods and Services

The most important feature of the state and local tax system creating compliance costs is the fact that all states and many local units of government differ substantially in the definitions of what is taxable. Although some definitions are likely to be uniform across states (books), others may not be (computer programs).

Proponents of simplification recommend that a set of uniform definitions be created to be used by all states. Lists such as the United Nations Central Products Classification Scheme and the North American Industrial Code System have been identified as possible starting points for developing the menu of definitions. Under this approach, each taxing jurisdiction can still decide unilaterally what is to be included in the base, but the components chosen from the uniform tax base menu would have the same definition wherever taxable.

Single Sales Tax Rate

Another, but less significant, factor contributing to the complexity of the sales and use tax system is the great variation in local tax rates within the states. The sales tax is imposed in almost 7,500 state and local taxing jurisdictions. Considering that ecommerce includes a large number of small firms selling into multiple states, there is a great deal of concern about the additional compliance costs associated with local sales taxes. The Washington compliance study provides some foundation for this concern. The study found that compliance costs related directly to local taxes accounted for over 50 percent of the compliance burden for small and medium retailers.

To simplify the sales and use tax system and reduce compliance costs for all retailers, there appears to be support for having a single, combined state and local tax rate for each

state. Under the one sales tax rate approach, each state would determine their own combined rate (and tax base) and remote sellers would submit collections to state tax agencies that would then distribute collections to local units of government.

Sourcing Transactions

The retail sales tax is a tax on consumers at the destination where the consumption occurs. States have designed sales tax systems that attribute or “source” consumption to the location of consumption, not production. Identifying where consumption occurs will become increasingly more difficult in the Internet environment where products can be delivered electronically without knowledge of the purchasers’ residence and payment can be made in ecash. Ecommerce has the potential to create a large and growing set of retail transactions that may be impossible or costly to attribute to a specific location.

Compliance costs would increase for ecommerce retailers if sellers had to gather information about the location of consumers that was not collected as part of the normal business process. An example that has been cited is to collect information directly from customers. Another example, verifying local address information from financial intermediaries, has been shown not to be a viable alternative given current technology.

One proposal for simplification in this area is to only attribute collections at the state level, not the local level, for electronically delivered taxable goods and services. Because compliance burdens for multistate companies increase with the number of taxing jurisdictions, this proposal could substantially reduce private-sector compliance costs. As is the situation under the single state tax rate alternative, states would have to then distribute the collections to local units of government based on distribution formulas.

In the case of products purchased over the Internet but shipped to customers, the “ship to” area or the “billing” area could be used to determine the state of consumption. Remote sellers could use this information, if they have a collection obligation, to determine the applicable tax rates. In transactions where even the state destination cannot be determined, a default method would have to be established for determining the state-by-state distribution of collections.

Coordinating Local Political and Tax Administrable Boundaries

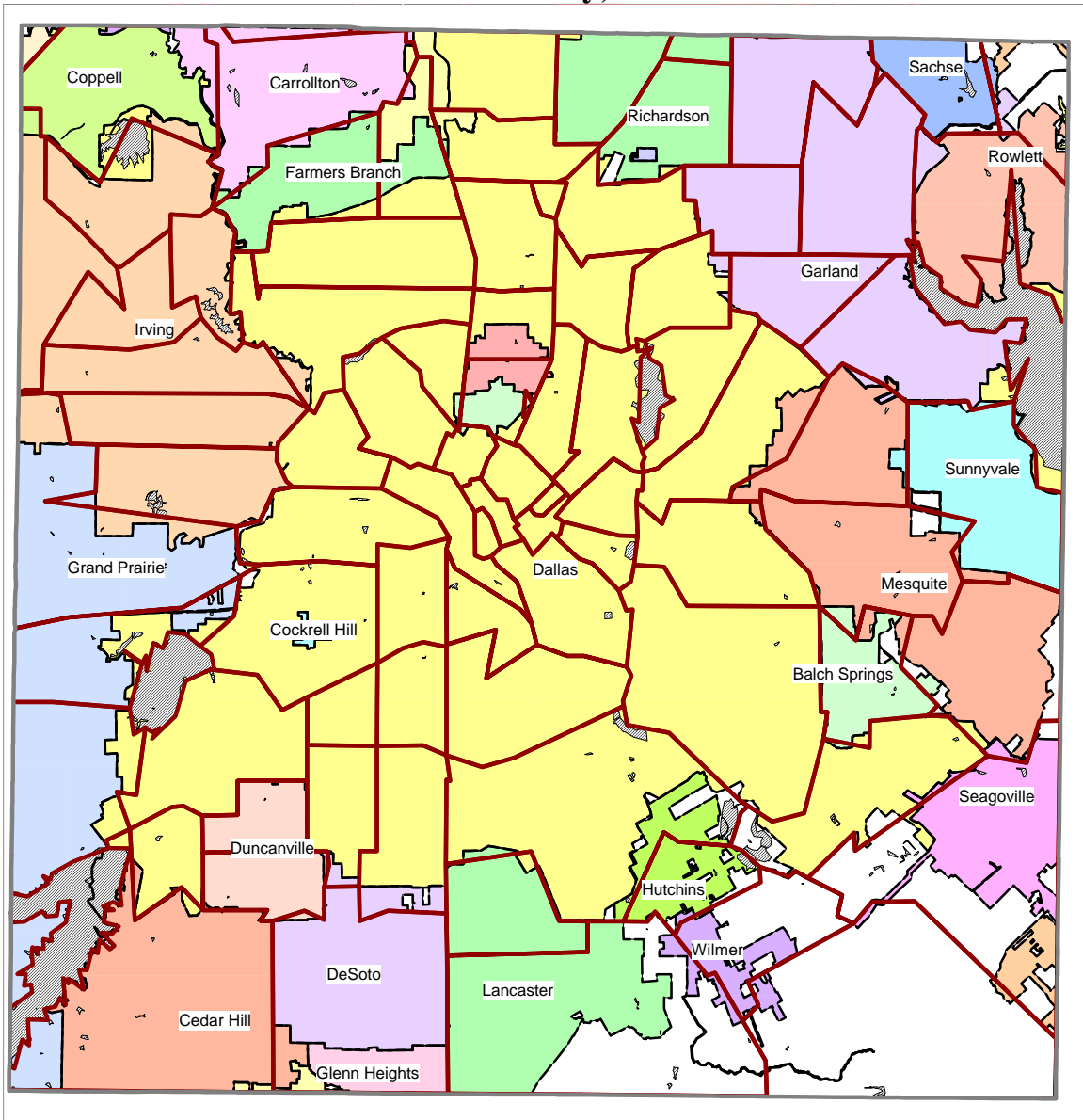
As mentioned before, there are supporters of sales tax simplification that are calling for single state tax rates or state-level attribution of sales that would effectively eliminate the obligation of remote sellers to collect and remit separate taxes to local units of government in states where retailers have nexus to collect the tax.

There are, however, other simplification options available that would retain separate local sales tax systems. For example, rather than eliminating the local taxes altogether, creating a more coordinated system of regional sales tax boundaries could reduce compliance costs. Instead of using local political jurisdictions to define tax areas, an

alternative would substitute other boundaries, such as United States Postal Service zip codes or zip + 4 codes, to define tax areas.

Figure 5 illustrates why this coordination of boundaries is necessary if zip codes are to be used for determining the location of consumers purchasing from remote sellers. The figure shows an overlay of zip code boundaries (in bold) on the local government jurisdiction boundaries in Dallas County, Texas. The figure shows clearly that zip codes and local sales tax boundaries do not line up. For example, on the eastern edge of Dallas, a single zip code includes three cities – Balch Springs, Mesquite and Dallas – with three different local city sales tax rates.

Figure 5
Mismatch of Local Government and Zip Code Boundaries,
Dallas County, Texas



Note: Zip code boundaries are outlined in red.

V. Conclusions

The complexity of the current sales and use tax system, along with the unique collection responsibility imposed on retailers, creates significant compliance burdens for multistate retailers, as well as small- and medium-size in-state sellers. This study highlights how significant these compliance costs can be for all retailers and describes additional compliance costs created by the unique characteristics of ecommerce.

Ecommerce retailers are experiencing additional compliance costs that reflect unique economic characteristics of the industry. Combined, these developments are generating renewed public- and private-sector interest in exploring options for restructuring sales and use tax systems to simplify the system, reduce compliance costs and compensate retailers for their collection responsibilities.

The key conclusion in this report is that isolated changes in the sales and use tax system to deal with ecommerce retail sales will not be sufficient to reduce the unacceptably high current costs of collecting sales taxes. What is needed is a fundamental restructuring of sales and use taxes to simplify the system, reduce compliance costs on retailers and consumers, and prepare the sales tax for the more competitive, integrative national consumer economy in the 21st Century. State and local governments must become masters of simplification to reduce the great burdens currently borne by multistate retailers.

Appendix

Sales Tax Vendor Discounts by State

State	State Sales Tax Rate*	Vendor Discount	Minimum or Maximum	Comments
Alabama	4.0%	5.0%, 2.0%, 3.0%	\$900/month (max.)	discount is 5% of first \$100 of tax due, 2% of excess
Alaska	none	N/A		
Arizona	5.0%	1.0%	\$10,000/yr (max.)	
Arkansas	4.625%	2.0%	\$1,000/month (max.)	no discount on use tax
California	6.0%	0.0%		
Colorado	3.0%	3.3%		
Connecticut	6.0%	0.0%		
Dist. of Columbia	5.75%	1.0%	\$5,000/month (max.)	
Delaware	none			
Florida	6.0%	2.5%	\$30/report (max.)	discount is 2.5% of the first \$1,200 of tax due; mail order retailers allowed up to 10% discount is 3% o the first \$3,000 and 0.5% of excess
Georgia	4.0%	3.0%, 0.5%		
Hawaii	4.0%	0.0%		
Idaho	5.0%	0.0%		
Illinois	6.25%	1.75%	\$5/yr. (min)	
Indiana	5.0%	1.0%		1.0% of tax liability
Iowa	5.0%	0.0%		
Kansas	4.9%	0.0%		discount on use tax is limited
Kentucky	6.0%	1.75%, 1.0%		discount is 1.75% of first \$1,000 of tax ; 1.0% of excess
Louisiana	4.0%	1.1%		
Maine	5.5%	0.0%		
Maryland	5.0%	1.2%, 0.9%		1.2% of first \$6,000 of tax due and 0.9% of excess
Massachusetts	5.0%	0.0%		
Michigan	6.0%	0.5%		discount is 0.5% of tax due at 4% rate, with no cap.
Minnesota	6.5%	0.0%		
Mississippi	7.0%	2.0%	\$50/month (max.)	
Missouri	4.225%	2.0%		
Montana	none	N/A		
Nebraska	5.0%	2.5%, 0.5%		discount is 2.5% of first \$3,000;0.5% of excess
Nevada	6.5%	1.25%		

Sales Tax Vendor Discounts by State (continued)

State	State Sales Tax Rate*	Vendor Discount	Minimum or Maximum	Comments
New Hampshire	none	N/A		
New Jersey	6.0%	0.0%		
New Mexico	5.0%	0.0%		
New York	4.0%	3.5%	\$150/qtr. (max.)	
North Carolina	4.0%	0.0%		
North Dakota	5.0%	1.5%	\$255/qtr. (max.)	\$85 monthly ceiling on discount for each location
Ohio	5.0%	0.75%		
Oklahoma	4.5%	2.25%	\$3,000/month (max.)	
Oregon	none	N/A		
Rhode Island	7.0%	0.0%		
South Carolina	5.0%	3.0%, 2.0%	\$3,000/yr. (max.)	discount is 3% on taxes less than \$100, 2% of tax on taxes of \$100 or more; separate discount for remote vendors
South Dakota	4.0%	0.0%		
Tennessee	6.0%	2.0%, 1.15%	\$50/report (max.)	discount is 2% of the first \$2,500; 1.15% of excess
Texas	6.25%	1.25%, 0.5%		discount is 0.5% of tax due plus 1.25% of prepaid tax.
Utah	4.75%	1.5%, 1.0%		monthly payers retain 1.5% of state tax and 1% of local tax
Vermont	5.0%	0.0%		
Virginia	3.5%	3.43%, 2.57%, 1.71%		discount is 3.43% if monthly taxable sales are \$62,500 or less, 2.57% if \$62,501 to \$208,000; 1.71% of excess
Washington	6.5%	0.0%		
West Virginia	6.0%	0.0%		
Wisconsin	5.0%	0.5%	\$10 (min)	discount is not to exceed amount of tax payable
Wyoming	4.0%	0.0%		

Source: State of Washington, *Retailers' Cost of Collecting and Remitting Sales Tax* and CCH Online.

*State's use tax rates were identical to the sales tax rates.