

# CRS Report for Congress

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## The Streamlined Sales and Use Tax Agreement: A Brief Description

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### Summary

Sales taxes are an important source of revenue for most states. The expansion of Internet commerce, where vendors and customers are often in different states, has eroded part of that revenue stream. As a result of U.S. Supreme Court decisions, states are prevented from requiring remote (out-of-state) vendors to collect sales taxes. The Court noted that it would be too burdensome on interstate commerce for remote vendors to comply with each state's unique tax code. For this reason, several states are participating in an initiative to simplify and coordinate their tax codes — called the Streamlined Sales and Use Tax Agreement (SSUTA). The member states hope that Congress could be persuaded to allow them to require out-of-state vendors to collect taxes from customers in SSUTA member states.

In the 109<sup>th</sup> Congress, two bills, S. 2152 (Enzi) and S. 2153 (Dorgan), have been introduced that would allow states that have adopted the SSUTA to compel out-of-state vendors to collect sales and use taxes. This report will be updated as legislative events warrant.

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### Sales Taxes and Internet Commerce

General sales and use taxes provide state governments with a significant share of total tax revenue each year. The use tax is the companion to the sales tax, applied to goods purchased from vendors outside the purchaser's state of residence.<sup>1</sup> Sales taxes generated about one-third, or approximately \$198.4 billion, of the \$593.5 billion of total

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<sup>1</sup> Use tax burden is created by the *use* of a good or service. The use tax collection burden generally falls on the consumer, rather than on the retailer as is the case with the sales tax. For the remainder of this report, "sales tax" will be used to refer to both the "sales" and "use" tax.

state tax revenue in FY2004.<sup>2</sup> Many local governments also depend on the sales tax. Local governments derived 11%, or approximately \$44.6 billion, of their total tax revenue from sales taxes in FY2003.<sup>3</sup> Generally, this sales tax revenue is collected by the retailer at the point of transaction and remitted to that state or local government. While the legal burden is on the consumer, the retailer acts as the collection agent for the state.

States and their local governments are concerned that the expansion of Internet commerce — and interstate transactions — will gradually erode their tax base. This concern arises because the U.S. Supreme Court has ruled that out-of-state vendors are not required to collect sales taxes for states in which they (the vendors) do not have nexus (usually defined as physical presence).<sup>4</sup> Note that at the time of these court decisions, interstate sales were primarily through mail-order catalogues.

The growth of Internet commerce is certain, though the size of the revenue loss is not. The Census Bureau of the Department of Commerce estimates that Internet commerce in the third quarter of 2005 jumped 27% from the third quarter of 2004.<sup>5</sup> For 2003 alone, revenue loss from uncollected taxes on Internet transactions was estimated to be \$8 billion.<sup>6</sup> Even though there is significant debate surrounding the current size of the sales tax revenue loss arising from the growth in Internet commerce, most observers agree that the tax loss is significant and will likely grow robustly over time.

Given their dependence on sales taxes, states have a significant incentive to maintain their sales tax revenue streams. Currently, one of the primary goals of many states is to have Congress pass legislation allowing member states to require collection of sales taxes by remote vendors. This effort was formalized by the Streamlined Sales Tax Project (SSTP), whose task was to craft an agreement paving the way for “streamlined” state sales taxes. This agreement is the Streamlined Sales and Use Tax Agreement or SSUTA.<sup>7</sup>

The SSTP, the entity that drafted the SSUTA, was created in 2000 by 43 states and the District of Columbia (D.C.). These states and D.C. wanted to simplify and better synchronize individual state sales and use tax laws. Its stated goal was to create a simplified sales tax system so all types of vendors, from traditional Main Street retailers to those conducting trade over the information superhighway, could easily collect and

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<sup>2</sup> U.S. Census Bureau, “2004 State Government Tax Collections,” available online at [<http://www.census.gov/govs/www/statetax.html>].

<sup>3</sup> U.S. Census Bureau, “State and Local Government Finance by Level and Type of Government: 2002-03,” available online at [<http://www.census.gov/govs/www/estimate03.html>].

<sup>4</sup> This legal status is shaped by two decisions regarding remote collection: *National Bellas Hess, Inc. v. Department of Revenue of Illinois*, 386 U.S. 753 (1967) and *Quill Corporation v. North Dakota*, 504 U.S. 298 (1992).

<sup>5</sup> U.S. Census Bureau, “Quarterly Retail E-Commerce Sales,” available online at [<http://www.census.gov/mrts/www/data/pdf/05Q3.pdf>].

<sup>6</sup> Donald Bruce and William F. Fox, “State and Local Sales Tax Revenue Losses from E-commerce: Estimates as of July 2004,” *University of Tennessee Center for Business and Economic Research*, July 2004, p. 5.

<sup>7</sup> For the most recent version of the agreement see, [<http://www.streamlinedsalestax.org/agreement.htm>]. It was most recently revised Jan. 13, 2006.

remit sales taxes. The member states believe that a simplified, relatively uniform tax code across states would make it easier for remote vendors to collect sales taxes on goods sold to out-of-state customers. The SSTP was dissolved once the SSUTA became effective on October 1, 2005.<sup>8</sup>

## Description of the Agreement

Under the SSUTA, member states request that remote sellers voluntarily collect sales taxes on items purchased by customers outside their home state. Vendors in participating states who voluntarily collect the sales tax would be offered amnesty for previously uncollected taxes. Participating states have agreed to share the administrative burden of collecting taxes to ease tax collection for sellers. The states' obligations under the SSUTA include the following:<sup>9</sup>

- **Agree to uniform definitions for all taxable items.** States participating in the SSUTA must define all goods in the same way. For example, a pumpkin could be defined as either food or home décor. In many states, food is exempt from taxation. All states will agree to one definition, so a pumpkin seller in Illinois would know the tax status of pumpkins in all states, not just Illinois. As another example, what percentage of fruit juice does a beverage need to contain to be considered fruit juice instead of soda? If fruit juice is taxed differently from soda, as is often the case, sellers could be confused by conflicting definitions in different markets. Each state retains the choice over whether or not the item is taxable. All local governments in a state must use the same state-defined tax base.
- **Simplify tax rates.** It is fairly common for states and local jurisdictions to tax different goods at different rates. This complication is mostly remedied under the SSUTA, as each state will be allowed only one tax rate (with an exception for a second state rate on food and drugs). Each state can add one additional local jurisdiction rate, based on ZIP code, to compensate for lost local tax revenue. The member state must maintain a catalogue of rates for all ZIP codes. For ZIP codes with multiple rates, an average rate for that ZIP code would apply.
- **Simplify collection.** Businesses will no longer file tax returns with each state (and sometimes local) government where they conduct business, as is often the case where the SSUTA has not gone into effect. Instead, sales taxes will be remitted to a single state agency. Thus, states will bear some of the administrative cost of the technology employed to implement the new system. Vendor compensation is still under negotiation.

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<sup>8</sup> Jeffery A. Friedman and Charles C. Kearns, "Federal Streamlined Sales Tax Legislation Introduced in Senate," *State Tax Notes*, Jan. 16, 2006, pp. 131-136.

<sup>9</sup> For more information, see [<http://www.streamlinedsalestax.org>].

## Which States Are in the SSUTA?

As of this writing, 44 states and the District of Columbia participate in the streamlining project, although 25 are not full or associate members of the SSUTA. Thirteen of these states are full members and another six are associate members. Only the full-member states will have taxes collected by remote vendors. Following is a listing of the status of each state.

**Full-Member States.** There are 13 full-member states that have changed their sales tax laws to fully conform with the agreement: Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, New Jersey, North Carolina, North Dakota, Oklahoma, South Dakota, and West Virginia.

**Associate-Member and Participating States.** At present, six states have begun implementing all the requirements of the project and are considered associate members: Arkansas, Ohio, Tennessee, Utah, Wyoming, and as of January 1, 2006, Nevada. These six states will become full members on January 1, 2008, when they anticipate adopting into law all the rules and regulations that accompany full membership. Other states and the District of Columbia are participating, but are not close enough to qualify as full or associate members. These 25 states are: Alabama, Arizona, California, Connecticut, Florida, Georgia, Hawaii, Idaho, Illinois, Louisiana, Maine, Maryland, Massachusetts, Mississippi, Missouri, New Mexico, New York, Pennsylvania, Rhode Island, South Carolina, Texas, Vermont, Virginia, Washington, and Wisconsin.

**Non-participating states.** The following states are not participants because they do not levy a statewide sales tax (Alaska, Delaware, Montana, New Hampshire, and Oregon) or they levy a statewide sales tax but have chosen not to participate (Colorado). Alaska does allow some localities to levy a local sales tax, but these localities are not represented in the SSUTA compact.

**The Stakeholders.** The streamlined sales tax enjoys the collective support of the National Governors Association (NGA). The NGA has endorsed the SSUTA with hopes that the agreement could address the Supreme Court's concerns about the burden on interstate commerce of collecting remote taxes. The association believes that requiring remote vendors to collect sales and use taxes under a new, simplified system could survive legal challenges.<sup>10</sup>

Other support comes from large "brick and mortar" retailers who must collect sales taxes and believe the current system provides an unfair advantage to Internet retailers who do not collect such taxes. Brick and mortar companies with a strong Internet presence, such as Walmart.com and ToysRUs.com, voluntarily comply with SSUTA guidelines and use them to collect taxes on remote sales.<sup>11</sup>

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<sup>10</sup> National Governors Association, "Key Committee Issues," available online at [<http://www.nga.org/portal/site/nga/menuitem.5361c0f4fe6e68d18a278110501010a0/?vgnnextoid=a2b1bf83c0e81010VgnVCM1000001a01010aRCRD&vgnnextchannel=455c8aaa2ebff00VgnVCM1000001a01010aRCRD>].

<sup>11</sup> Wyld, David C., "Don't Shoot the Internet," *Computerworld*, vol. 37, Issue 27, p. 21 (2003). Viewed online through Academic Search Premier (Jan. 10, 2006).

On the other side of the issue are individuals and businesses that benefit under the current system. Consumers in states with high sales tax rates can purchase goods online and easily evade paying sales taxes.<sup>12</sup> Businesses that sell goods online to these out-of-state consumers also benefit as their products, absent the sales tax, are marginally less expensive than the brick and mortar alternative.

Also opposing the SSUTA are several anti-tax groups who see the SSUTA as a new tax burden rather than a simplification of the current tax system.<sup>13</sup> Anti-tax groups also argue that states compete to attract businesses and customers through lower tax rates and that this competition is good for consumers.

Many businesses are taking the middle ground in this debate. They understand the states' desire to more efficiently collect sales tax revenue in a fair manner but, not surprisingly, they ask for greater simplification and increased vendor compensation from the states for collecting state sales taxes.

## Issues for the 109<sup>th</sup> Congress

In the 109<sup>th</sup> Congress, S. 2152 (Enzi) and S. 2153 (Dorgan) would grant full-member states in the SSUTA the authority to compel out-of-state vendors to collect sales and use taxes on remote sales.<sup>14</sup> Both bills would respond to the Supreme Court's recommendation in *Quill* that Congress act, under the commerce clause, to clarify state sales tax collection rules. More specifically, the legislation would allow states that have fully adopted the simplified tax system to collect sales taxes from sufficiently large businesses even if those businesses do not have a nexus in the state. Generally, in S. 2152, a "sufficiently large business" is one with nationwide sales of greater than \$5 million. S. 2153, in contrast, assigns the responsibility for defining a small business to the Small Business Administration (SBA), with the ultimate approval of Congress. Both bills would set minimum standards of simplification before states would be allowed to demand remittance of sales and use taxes. The proposed legislation would have the Court of Federal Appeals review any disputes related to tax collection.

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<sup>12</sup> As described earlier, consumers are required to remit consumer use taxes to their state of residence if the remote vendor has not collected the tax. Not paying use taxes is tax evasion. However, states typically do not pursue collection from these consumers, as the tax yield could be considerably smaller than the cost of enforcing use tax remittance.

<sup>13</sup> Americans for Tax Reform, "The Streamlined Sales Tax Proposal: A Tax Increase Under the Radar," Policy Brief, Undated material available on the Internet at [[http://www.atr.org/content/pdf/2005/dec/120704ot\\_SSTPpb.pdf](http://www.atr.org/content/pdf/2005/dec/120704ot_SSTPpb.pdf)].

<sup>14</sup> The U.S. House Small Business Subcommittee on Regulatory Reform and Oversight held an oversight hearing on the streamline legislation, S. 2152 and S. 2153, on Feb. 8, 2006. The submitted witness testimony is available from the subcommittee website at [<http://www.house.gov/smbiz/hearings/databaseDrivenHearingsSystem/displayHearings.asp?congress=109>].