

**Sales and Use Tax Simplification
and Voluntary Compliance**

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Introduction

Since the 1930s the retail sales tax has become an important and resilient source of revenue for state governments in the United States. Current data show that for the 45 states that employ the sales tax, it contributes in excess of 30 percent of their annual revenue. For some states the relative share of revenue coming from the sales tax exceeds 40 percent. Beginning in 1934, the authority to levy the sales tax was extended to local governments, and it is now available to local governments in 34 of the 45 states using the sales tax. The local sales tax funds cities, counties, school districts, special districts, and mass transit systems. In addition to financing current operations of state and local government revenue from the sales tax also supports the repayment of public debt (Cornia, et al., 2001). In aggregate the significance of the sales tax is also growing at the local level. Part of the growth in the importance of the local sales tax comes from the economic growth in the United States, and some from increasing existing rates; but a substantial part of growth of the sales tax at the local level comes from the expansion in the number of local governments using the tax. Over the past two decades an average of 600 local governments have taken advantage of the opportunity either to employ the sales tax or increase the rate of the existing tax. Local sales taxes are commonly called *local option sales taxes* because in most situations, local governments must exercise a state-granted option before they can collect the tax.

Much of the success of the sales tax in the United States is attributed to the fact that the responsibility for the collection of the tax is imposed on retail businesses or vendors that sell taxable goods and services to final consumers (Due and Mikesell, 1994). In order to operate legally as a vendor, a firm must register with the state and obtain a sales tax license. This practice is clearly the norm for vendors selling directly to final consumers (B2C). Business firms that sell to intermediates or other businesses (B2B) also play a role in the collection of the sales tax. B2B vendors comply because, like B2C

¹ This paper is based on a series of discussions and ongoing research I am involved with that includes David Sjoquist, Georgia State University, and Larry Walters, George Mason University. Professors Sjoquist and Walters share none of the blame for this draft of the paper but contributed to many of the ideas.

vendors, they are required to register with the state; and state revenue departments frequently audit books of both vendors and buyers, and conformity with the use tax is a common audit examination. However, the number of B2B firms that do not register may be quite large. In their roles as vendors, B2C firms and B2B firms essentially act as tax agents for state revenue departments. Customers who are generally responsible for the sales tax, or are typically assumed to pay the tax, or bear the incidence of the tax, face negligible burdens, in the collection of the retail sales tax (Due and Mikesell, 1994).

Within a few years of the adoption of the sales tax, retail businesses and state revenue departments in states that had adopted the retail sales tax felt they were facing unfavorable competition from retailers in states that had not adopted a sales tax. Customers could choose to go to a neighboring state without a sales tax and avoid paying the tax. There were also issues in states with lower tax rates gaining a market advantage. Beginning in Washington and California, states responded to this challenge by adopting a *use* tax. The use tax is virtually identical to the sales tax, except it is imposed on the use or consumption of the taxed good or service; and the value of the consumption is based on the sales price of the good or service. The intent of a use tax is to offset the incentive to purchase from vendors in states with low sales tax rates or no sales tax. At the present time every state with a general retail sales tax has also adopted a use tax. The legality of the use tax was quickly challenged in a Washington state case, and the U.S. Supreme Court upheld the constitutionality of the use tax in 1937 (*Henneford V. Silas Mason Co., Inc., 1937*).

Although the use tax has spread to every state employing a sales tax there has been limited success collecting the use tax. Unlike the retail sales tax, which requires in-state B2C and B2B vendors to collect the tax, state and local tax administrators have not been able to impose a similar compliance and collection requirement on the use tax. The ability to collect the sales tax versus the inability to collect the use tax has created a variety of policy concerns. The concerns focus on lost revenue and creating unfair advantages for firms not collecting the use tax (Bruce, Fox and Murray 2001). Differences in tax burdens also create incentives for tax lobbyist (evasive specialists) to confer with governments to give even more tax reductions (Palda, 1998). For the past four decades, state governments, federal agencies, state agencies, state legislative bodies,

the U.S. Congress, and business groups have engaged in a series of studies, administrative compacts, negotiations and court battles concerning the conflicts around collecting the use tax. The initial attempts to resolve these issues were concerned with the collection of the use tax on catalog or mail-order sales. Starting in the late 90s, issues related to the collection of the use tax began to focus on the Internet and E-commerce. A partial list of the efforts to resolve the compliance and administrative issues related to the use tax is given in table one. Table one also identifies whether the major focus of the analysis was on catalog sales or on E-Commerce.

[Insert Table 1 Here]

The general strategy of state governments and their agents during the various schemes listed in table one was to develop a process that would compel nontraditional vendors, or vendors that sell goods and services without using a “storefront,” to collect and remit the use tax. Conversely, it appears the strategy of the nontraditional vendors has been to use the processes to protect them from any obligation to collect the use tax. To date the events in table one have been at best a tie, resulting in no changes, and more often than not a resounding defeat for state revenue departments.

Nontraditional vendors have resisted the pressure to collect the use tax; they believe that to do so would place a substantial compliance burden on them, and collecting the use tax may reduce their sales. The compliance burden is more difficult for multistate vendors because they need to be familiar with the various state tax bases and state and local tax rates. Charles McLure (2002) observes the following about the US retail sales tax: “The current sales tax ‘system’ is extraordinarily complex—literally a compliance swamp, especially for vendors who must collect tax on sales to customers located in multiple states” (p. 4). There is evidence that states recognize that compliance is costly. Due and Mikesell (1994) report that states compensate instate vendors for their costs at rates between one and three percent of the sales tax collected. The Washington State Revenue Department (1998), in a study of firms in Washington, estimated the cost of use tax was over three percent for most firms. Cline and Neubig (1999b), extending the

Washington methodology to vendors, estimated that the compliance cost for such firms can exceed seven percent of the collected use tax.

On two separate occasions, *Bella Hess* (1967) and *Quill* (1992), the United States Supreme Court has sided with the nontraditional vendors and ruled that they could not be compelled to collect the use tax. In the *Bella Hess* case the Court reasoned that unless a firm has a physical presence or a physical *nexus in* a state, a practice of forcing them to collect the use tax would violate due process protection and the commerce clause. In the more recent *Quill* case, the Court retained the nexus test; however, the Court concluded that due process would not be violated if compliance requirements were imposed, and indicated that Congress could resolve the issues with respect to the commerce clause. However, Congress has also not been able to move beyond the current status and solve the problem. The physical presence nexus test remains the law of the land. As a result of the *Bella Hess* and *Quill* decisions, the status of use tax compliance is as follows. Except in some B2B transactions, nontraditional B2C vendors where there is no physical nexus do not collect the use tax from their out-of-state customers and clients. Of course, B2B transactions are a significant part of the sales and use tax base.² Ring (1999) estimates that B2B taxable sales comprise over 40 percent of the total sales and use tax base. States have tried to get retail customers to voluntarily comply with the use tax on goods purchased from out-of-state vendors. These efforts have not been successful (Freiden, 2000). Jones (2002) suggests that taxpayers simply have no idea that they owe the use tax.

Beginning in 1999, elected state officials, executive, legislative, and appointed state tax administrators embarked on a considerably different path to facilitate collecting the use tax. State officials acknowledged that the complaints raised by B2B and B2C vendors about the expense and burden of use tax compliance had validity. And a group of states decided to engage in a process to standardize and simplify their sales and use tax systems, with the intent to reduce the compliance burden for nontraditional vendors. In the context of federalism, both in terms of state governance and state fiscal issues, we

² Economists generally argue that retail sales tax should not be collected on B2B transactions because it causes distortions in the price of goods. Recent work by Bruce, Fox and Murray (2000) suggests that taxing intermediate goods in a retail tax scheme may only cause limited distortions and may actually increase efficiency by taxing goods that would otherwise not be taxed.

note that the process of reform is a bottom up approach to the resolution of a multistate problem.

The process, now labeled the Streamlined Sales Tax System (SSTP), has had 27 states join the coalition. In order to participate in the STTP program states are required to legislatively adopt specific statutory language that grants the state the authority to enter into the process. Full membership in STTP allows a state voting rights and standing in all deliberations. States can also participate as nonvoting affiliates. As in earlier attempts to resolve these issues, representatives of the business community, including traditional storefront vendors, B2B vendors and nontraditional B2C vendors, have joined with the states in this effort. In the early stages of the process the participating states identified the major compliance and administrative concerns of the use tax. Table two lists these major problems and some of the solutions being examined.

[Insert Table 2 Here]

Most of the issues listed in table two are not new; e.g., vendor compensation for the sales tax is allowed in one-half of the states, tax compliance software is already used, and the need for administrative simplification has been discussed for several decades (Haughton and Cornia, 2000). The uniqueness of the STTP approach is that the states are banking on the assumption that by making the process of complying with the use tax straightforward and transparent, nontraditional B2C vendors will conclude it is now in their interest to begin collecting the sales and use tax. Even without the concerns around use tax compliance states will likely benefit from sales and use tax simplification. For example Agha and Houghton (1996) report higher VAT compliance in the European countries where rates are lower and tax bases more uniform. The obvious policy question is whether a system can be made simple enough to make it compliance easy and whether voluntary compliance will succeed where efforts to force compliance have failed.

The purpose of this paper is to consider the obstacles that may prevent voluntary compliance to succeed. The paper proceeds as follows. We first consider the revenue loss associated with the use tax and we then consider the administrative and policy considerations with respect to use tax simplification. We then review concerns that firms may face if they comply with the use tax. These include lost sales, exposure to other

taxes, and firms behaving as free riders. The next topic focuses on the likelihood that states can actually simplify their tax systems. The final section of the paper offers an initial analysis on the likelihood of voluntary compliance.

Does The Use Tax Matter?

An important question on the use tax is that in terms of lost revenue and the increased compliance costs, is it worth the effort required to collect it? That is, from the nontraditional vendor's perspective, is the effort and expense needed to collect the use tax too onerous, and from the perspective of state and local governments is the revenue lost from the use tax large enough to be concerned about? As noted, on two occasions the Supreme Court has considered these questions, and the decisions imply that the Court has not felt the revenue issues were sufficient to overcome the compliance objections raised by the nontraditional vendors. Essentially, the Court said that the complexities of collection are important enough to matter, and the revenue losses are not sufficient enough to matter. However, since the two Court decisions, the world has changed.

Administrative Concerns

Unfortunately, since *Quill*, the administrative and compliance issues of the sales and use tax have become even more complex. At the time of *Bella Hess* and even *Quill*, nontraditional vendors composed only a small portion of the national economy. However, more and more vendors, large and small, are conducting business in nontraditional ways and providing service and products to customers in multiple countries, multiple states, and thousands of local communities or in locations where the vendors do not have nexus. The driver for the growth in nontraditional vendors has been the Internet, which allows a firm to develop processes to market goods and services with modest capital and operating requirements. And the Internet gives a vendor access to millions of potential customers once it posts notice that a particular product is available³. As the Internet has evolved, the relationship between the vendor and the customer has become even more difficult to understand. Nowhere is the difficulty of understanding the emerging businesses more apparent than it is on the issue of collecting the use tax.

³ We do not want to suggest that merely putting up a web site guarantees marketing success. Wiseman (2000) discusses the difficult challenges of being successful marketing products over the internet

There are standard steps that participants in a tax system, either the tax administrators, taxpayers, or both, must complete to successfully collect taxes. Steps include the discovery of taxable activities or events, establishing the taxable value of the event, developing an inventory of taxable events, imposing the tax on the event, billing and collecting the tax, the opportunity to appeal the imposed tax, and finally, a system to audit the process (Mikesell, 2000). Traditional vendors, both B2C and B2B, accomplish most of these steps as a normal part of their operations. Their accounting and information systems allow the tracking of sales or events, as well as computing, billing and collection for the event. The systems also maintain functional and financial histories or inventories of the events that facilitate financial and tax audits. In almost every regard, the accounting and information practices of nontraditional vendors and traditional vendors are very similar.

In fact, the similarity leads some to wonder if the complaints from nontraditional vendors about use taxes are overstated. Nonetheless, we believe nontraditional vendors face compliance complications⁴. Some of the compliance issues are mostly administrative and appear correctable without major use tax policy changes. For example, the first challenge confronting a nontraditional vendor is becoming a registered agent in each state where it does business. The vendor must then file tax returns in a timely manner. The STTP participants are planning to solve this problem by adopting uniform vendor registration and filing requirements. Other administrative problems that do not involve complicated tax policy issues include the process of determining the exempt status of purchases, determining the exemption of goods sold for resale, state-by-state record requirements, and state-by-state audit practices. There are also problems, often quite complicated, related to dealing with bad debts and credit card transactions. Table three offers a partial list and brief description of STTP proposals to minimize administrative issues around use tax compliance.

[Insert Table 3 Here]

⁴ For example, one problem Internet companies face is the lack of historical accountancy and financial data (Trueman, Franco, and Zhawg, 2000). Lack of financial data makes audits more difficult.

Base

The other compliance issues are simply more complicated. While the issues are fundamentally administrative, every problem has tax policy implications. The first of these is the predicament caused by the nonuniform state sales and use tax bases. In fact, about the only uniform aspect of the sales and use tax base is the nonuniformity of the tax base among the states. Nonuniformity of the base is a modest issue if a vendor operates in one state or even only a few states and sells only a limited number of products.

Nonuniformity in the tax base creates complexity for vendors doing business in multiple states and the complexity increases as the number of products sold increases. The CEO of Federated Department Stores indicates his firm must track the taxability of over three million products (Julian, 1999). The fundamental problem in such situations is that the vendor must determine if a good or service is taxable in the state or locality where the consumer or purchaser resides. Solving this problem is not easy, given the thousands of distinct goods and services that are potentially taxable and potentially exempt. Requiring a vendor to follow the differences in the sale and use tax bases may be an impossible task. In terms of specific tax administration steps, nonuniform bases create a serious issue for the discovery of taxable events.

This administrative or compliance problem of discovery is especially acute when there are exemptions to the sales and use tax base. Exemptions in the base are given for all kinds of reasons and vary among states and even within states. The exemption may be based on the nature of the good or service, e.g., food and medical care. These kinds of exemptions, driven by observable characteristics, are somewhat easy for a vendor to follow. Exemptions may also be based on the use of the good or service, the status of the purchaser of the good or service, or whether the good or service is being purchased for resale. These exemptions are much more difficult to follow, because the vendor now needs to know not only the status of the good but also the status of the buyer.

Exemptions are generally based on specific legal language in each state; and while difficult to track, the statutory expressions allow a tax department at least to know where to look when trying to identify exemptions. Exemptions for goods and services can also be extensive. In California, for example, there are over 120 specific exemptions to the general sales and use tax base (Micheli, 2001). The variety of exemptions is

illustrated in Table four, which highlights the differences in sales and use tax bases across the United States. However, table four only begins to illustrate the problems with exemptions. State codes contain pages and pages of detailed language related to exemptions. The significant differences in the sales tax bases of states are discussed in McLure (1999) and Mikesell (2000)⁵.

[Insert Table 4 Here]

One solution to this challenge would be the development of a uniform national sales tax base. This base would change dramatically the tax base for most states and would perhaps need to be coupled with revenue-sharing schemes to protect states from revenue losses. However, even with revenue redistribution designed to hold every state harmless, there is little reason to expect such a solution to have any viability in a nation with a tradition of state and local fiscal autonomy. Other less dramatic suggestions have included adopting uniform classification protocols, such as the U.S. Census Bureau's Standard Industrial Classification code or the United Nations Centralized Product Classification system (Houghton and Cornia, 2000). These ideas have proven almost as difficult to develop as adopting a uniform tax base. Analysis has shown that most of the international or national classification systems either focus on the production side of the economy or the consumption side of the economy, or have too much detail or too little detail; and almost all of them are generally silent on the definition of services (Houghton and Cornia, 2000).

The STTP plans to deal with the base issue through the development of a set of standard definitions or classifications that each of the participating states can implement. The definitions would be used to uniformly describe both taxable and nontaxable products and services in the respective state sales and use tax laws. The definitions would be consistent among the states, but what was taxable would not be uniform. The determination of the taxability would remain with each state. Even though the goal of this effort is intended to have no consequences on the tax base of the participating states, it is proving very difficult. For example, commodities such as candy, taxable as food under

⁵ The other major issue around the sales and use tax base is the growing number of services that are not subject to either tax (Brunori, 2001).

one definition, may no longer be taxable under a uniform taxation.⁶ The biggest issue is that some of the proposed definitions appear to include items in the tax base that are now excluded.

Rates

The third area of administrative concern that has policy implications is the practice of multiple sales tax rates within a state. Local tax rates may be imposed to fund the city, transit authority, cultural authority, and local hospitals. And the imposition of the different taxes is never uniform within a state. Vendors that sell products and services in a variety of states must track the correct rates to charge their customers. In the 35 states where local governments can use a sales tax, keeping track of the variety of rates is an impediment to accurate compliance. For example, rate differences create billing problems for vendors, and if an audit finds they undercharged on the rate, audit relief is not commonly granted. Likewise, there is an expectation that the use tax will be remitted to the correct set of state and local governments. The number and variety of sales tax rates in each of the 50 states is listed in table five. And as noted, the number of local governments using the local option sales tax and the existing rates change constantly. For national vendors, the total number of jurisdictions with a sales tax is now in excess of 7400.

[Insert Table 5 Here]

One solution to this problem would limit a state to only one sales tax rate. Adopting this strategy would reduce from 7400 to 45 the number of tax rates that vendors must monitor. This solution would remove the option which local governments now have to impose a sales and use tax. The obvious objection to this approach would come from the local governments that rely on the sales tax. However, states could offer fiscal transfers to hold harmless current users of the sales and use tax, but this is not an easy solution to implement. Finding the revenue to fund the transfer would require an increase in the current state tax rate. The process would also need to provide adequate protection for bonds guaranteed by sales and use tax revenue; and devising a revenue sharing

⁶ McLure (2002) describes a situation which a Kit-Kat bar may be taxed as candy in one state but exempt in another as a chocolate-covered wafer cookie. Julian (1999) offers the example of the taxation of a handkerchief, taxable in some states and exempt in others.

scheme that is acceptable to local communities and service districts is never easy. An analysis of adopting a one-rate system and increasing the state rate to provide revenue to compensate local governments for their lost revenue was conducted in five states – California, Georgia, New York, Tennessee, and Utah. Serious implementation and political problems were found in all five states, and the authors concluded that a single tax rate is not acceptable (Cornia, et al., 2000). We note the analysis did not examine the more difficult states like Alabama, Louisiana, and Texas. Alabama and Louisiana have high local rates and Texas has 1300 sales tax jurisdictions (Vertex, 2000).

The current STTP proposal would allow states to continue to have multiple local option rates but require that state and local governments become systematic in notifying vendors of changes in rates. Possible suggestions include allowing rate changes or adoptions to become effective only on a specified date and becoming effective only after a substantial lead time for notification of change or adoption has been in place. Requiring state and local governments to supply to vendors an electronic database that can be used to identify all purchasers by a unique identifier is also being evaluated. The plan is to allow vendors to upload data on sales and use tax rates that correspond to Zip codes.

Other issues associated with rates complicate use tax compliance. For example, rate differences in a state are generally a function of geography or location; e.g., different cities within a state have different rates. But there are also differences in the rate that are based on the purchaser and not the good or service. About half of the states with a sales tax have rates on goods that differ from the general state sales and use tax rates. An example is food items purchased from a store are taxed at rates that are different from the rates on food items purchased from a vending machine. Other examples where rates are different from the general state rate include cars sold to active military, food and drugs, industrial machinery, computers, sales to farms, sales to people over 85 years old, and agricultural machinery. Here the STTP process is more aggressive, suggesting that states remove from their laws most of the existing rate differences based on product or product use.

Technology

A key step in the STTP proposal is the development of technology processes that can assist with the compliance of the use tax. For example, Godsbee (2002) is explicit

that compliance simplification is critically linked to technology. The assumption is that working cooperatively, STTP and commercial vendors of software technology can develop use tax compliance software that can be integrated with existing vendor information technology. The STTP proposal allows firm to either contract with a certified service provider or develop their own Certified Automated System. Either system will be verified by the member sales. The advantage to a firm using these systems⁷. Considerable distance is yet to be covered in the development of technology to administer the use tax. However, progress is being made. There is now in place a pilot study of a use tax compliance process that is driven almost entirely by technology. The system determines if the product is taxable and whether tax rates are to be applied to the product, and eventually remits the collected use tax to the appropriate state and locality (Hardesty, 2001).

Revenue⁸

For the first 65 years of the use tax, the typical vendor was a mail-order catalog company, and purchasing goods from such a firm was cumbersome and slow, both in placing and receiving the order. As late as the mid-1980s the revenue loss from the use tax was modest (ACIR, 1986). Concern about the amount of tax revenue lost from the uncollected use taxes is now much changed. In the late 1990s there was no evidence that state or local governments had experienced any serious reduction in their sales tax collections (Cline and Neubig, 1999a). However, more recent work by Bruce and Fox (2001) suggests that state governments can expect to face sizable reductions in future sales tax revenues. In making their estimates, Bruce and Fox considered the loss associated with sales to consumers, and also B2B sales. Data reported by Bruce and Fox (Table 6) suggest that over one-fourth of the states will see reductions in sales tax revenues in excess of ten percent by the year 2011. The total amount of lost use tax revenue could exceed 55 billion by 2011.⁹

⁷ As discussed later in this paper. Similar proposals for contract collection practiced were subjected to serious criticism.

⁸ We only consider the loss of associated with the use tax. However, there are other revenue losses that accompany Internet transactions such as the taxes due on capital gains (Albring, Mills, and Plumlee 2000).

⁹ A key assumption of the work by Bruce and Fox is that a substantial portion of B2B use tax goes uncollected. Goolsbee (2001) questions the assumptions that Bruce and Fox use in this part of their estimates. However, the GAO (2000) reports a general belief among state tax administrators that there is considerable underpayment in the B2B use tax.

[Insert Table 6 Here]

Bruce and Fox (2001) also estimated the loss of revenue for local governments that rely on the sales tax. They report losses of local revenues of a magnitude that would make it difficult for many cities to continue to provide their current level of services.

These outcomes might strike some individuals and groups as acceptable. Lower revenue is one way to reduce the size of government, or at least slow its rate of growth (Becker, 2000). However, as we have learned from other tax-limitation decisions, there is no guarantee that the reduction in a tax will not be offset by an increase in other taxes and fees. One problem is that the new revenue sources have a variety of shortcomings when measured against the normative criteria generally associated with the public finance literature. Likewise, the loss in revenue may reduce expenditures in areas where some consider the functions critical. Perhaps the most important reason subnational governments should be concerned about the loss of revenue is the threat it presents to federalism. Losing a local source of revenue can result in the reliance on a centralized source of revenue and the potential loss of fiscal and political autonomy.

There are alternatives to offset the loss of revenue from the use tax. One option is to seek another source of revenue. Litan and Rivlin (2001) speculate that solving the compliance issues around the use tax may be too burdensome and may also create too many market distortions. They argue that state governments should consider reducing their reliance on sales and use taxes and then suggest that states could make up the lost revenue through greater reliance on a state income tax. This suggestion would likely have little support from state officials because the states consider the sales tax as a source of revenue by which they retain control over most of the policy questions around the tax base and tax rates. Conversely, more and more of the policy and administrative issues of income taxes are conceded to the federal government.

Local governments could also consider increasing their reliance on local option income taxes. However, few local governments have the opportunity to take advantage of this option. Few states grant an income option authority to local governments, and in these states, except for Ohio, few governments have opted to use local income taxes.

There is also a concern that if local governments began to rely on income taxes there would be serious policy fights over making the income tax a residence-based or source-based tax (Cornia, et al, 2000). Local governments could also try to use the property tax more aggressively. Again, any suggestion to increase the property does not have much promise. Property taxes and increases in property taxes have become increasingly contentious, resulting in the imposition of various types of property tax limitations in a number of states (Mullins and Cox, 1995).

On balance we believe the current estimates in the loss of revenue to be of sufficient size to create serious fiscal issues in the near future. Not all share this view. Goolsbee (2001) senses that the revenue loss will continue to be modest. There is also reason to expect that the revenue and administrative problems will become even more serious. When the STTP began, there were 245 million Internet users in the world; by 2005, when the project is completed, the number of worldwide Internet users will approach one billion (Goldberg, 2002).

Questions About Voluntary Compliance

For a variety of reasons, voluntary compliance with the collection of the use tax raises questions. The first concern is that there is no legal requirement or contract between STTP states and the vendors in terms of organizational and institutional relationships. This lack of a legal relationship is a serious issue. The industrial organization literature suggests that unless a binding contract is in place, the opportunities and incentives to renege on agreements between principles and agents in a relationship can overwhelm either party. Klein, Crawford, and Alchin (1978) argue that incentives to take advantage of other parties are so strong that firms often vertically integrate, even at the cost of efficiency, to avoid unfavorable outcomes. Vertical integration is adopted because even contracts can't prevent principal and agent conflicts. The question is whether vendors operating without a legal contract will ignore the opportunities and incentives to capture sales and minimize costs and act as agents for the state and collect the use tax. In general, agency theory suggests that policy-makers and tax administrators should be wary about the assumption that uncompelled agents or vendors will represent the state and collect the use tax.

Finding behavior of people who contribute to the good of an organization or association on a purely voluntary basis is common. Religious organizations (Iannaccone, 1998), voluntary fire departments, and boys and girls clubs are among many examples. There are also situations in which groups participate in programs that benefit the community, even though they are only partially compensated for their activities. The distribution of surplus cheese during the 1970- 80s is an example (Lipsky and Thibodeau, 1988). Voluntary compliance, or self-reporting, also has a role in the environmental issues that are associated with violations of the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) (Kaplow and Shavell, 1994).

On the other hand, there are illustrations of individuals not participating in fundamental social activities that are important to a society. Choosing not to get involved in the prevention of or intervening in an occurring crime is an example of avoiding responsible voluntary, though not riskless, behavior. There are more general practices of society that undermine democracy. The obvious example of such action is the growing erosion in the percent of eligible voters who actually vote (Draggar, 1981). Decisions not to participate in the mainstream economy further illustrate people who opt not to be part of activities basic to society. There is evidence of a substantial underground economy in the United States that is at least partly motivated by the desire to avoid paying taxes (Jung, Snow and Tradel, 1994). Evidence exists that “voluntary behavior” increases when there are consequences of not participating. Dubin, Graetz, and Wilde (1992) report evidence that as the percent of income tax audits by the IRS is lowered, the rate of income tax filings also declines.

In light of all this, there is robust evidence that individuals do voluntarily comply with the individual income tax. The models that predict individual taxpayer compliance all predict the actual occurrence of a much lower level of participation. Joel Selmrod (1998) observes, “Given the probability on audit and the penalties typically assessed, evasion seems to be a winning proposition for many more people than actually evade. From this perspective, the puzzle is not to explain why people evade, but rather why people pay taxes – in the context of the standard economic model, people who voluntarily comply are exhibiting nothing short of ‘pathological honest.’”

Politically Acceptable to Avoid Taxes

Convention plays an important role in society. Informal relationships and expectations that develop within an organization and among organizations are used to minimize transaction costs. Convention is also important in public activities. For example, most adults and young adults have a sense of the appropriate behavior at a high school or college soccer game. And such convention allows groups to enjoy large and emotional crowds, even though a portion of the assembled will be disappointed at the end of the contest. In the context of the use tax, convention is not part of the informal relationship between vendors and public entities. More to the point, the current convention seems to be to do everything possible to avoid complying with the tax. Consider current political behavior.

A prevailing and strong political strategy in the United States is to oppose existing tax levels and to propose a reduction in taxes. It is an uncommon candidate who runs a political campaign at any level of government on the basis that if elected he or she will increase taxes. Electable candidates are those who appear to be motivated by a desire to generally limit government, at least not to increase taxes. Not only are taxes bases and tax rates attacked, attacks are mounted against institutions and individuals who have the responsibility to administer tax systems. In the past several national elections a number of prominent political figures – Robert Dole, Steve Forbes, Ross Perrot, and Pat Buchanan – have demonized the Internal Revenue Service (Alvarez and Brehm, 1998). One outcome of such behavior, and we hope it is unintended, is to undermine the ability of the IRS to collect taxes.

These anti-tax and anti-tax administration attitudes are common in much of the debate over the collection of the use tax. Political support for the use tax, a tax already part of the tax law in 45 states, is difficult to find. The Internet Tax Freedom Act has no consequence on the liability associated with the use tax, and the use tax is still the law of the land in 45 states. All the Internet Tax Freedom Act does is prohibit access charges on the Internet and discriminatory taxation; it is silent on the use tax. Nevertheless, public officials who have used the debate around the Internet Act to discuss the use tax have

been characterized in unfavorable ways, and some would say unfairly so. They were only trying to make the collection of the use tax part of the national agenda.¹⁰

Tax Clubs

The STTP essentially asks nontraditional vendors to join voluntarily in a collective to comply with the use tax. Collective behavior does occur, but experience teaches a number of important lessons about the success of collective groups. Olson (1971), in his book on collective behavior and the dynamics of group interaction, identifies a series of conditions that will undermine voluntary group cohesion. Many of Olson's conditions that undermine group cohesion apply to the current situation with use tax compliance. Most notably, a challenge to voluntary compliance occurs when there is a mismatch between costs and benefits. That is, costs are easy to find and benefits are hard to measure. Thus, the question whether tax clubs comprised of use tax compliers will develop.

The costs to the firms that are created by complying with the use tax are not immaterial. As noted earlier, compliance costs have been estimated to be as high as three percent and perhaps double that amount for vendors operating in multiple taxing jurisdictions. Thus, if a firm collects \$100 in sales tax, it must remit the full amount to the taxing authority, and the \$3 of collecting the tax is subtracted from the firm's bottom line as a cost of doing business. The cost is much higher in the case of purchases that are made with credit cards or checks, or result in bad debts for the firm. The costs may double for out of state vendors. These costs are easy to identify, and they undermine the financial health and long run viability of a firm.

Conversely, the benefits to the firm for collecting the tax are difficult to identify. The firm cannot point to better police or fire services provided by the revenues from the collected tax. Even if they could identify improved public service, it would not matter, because out-of-state vendors would find it very difficult to benefit directly from any expedition. Vendors will also not be able to identify lower overall tax rates because they have decided to collect and remit to the state or local government the use tax. The

¹⁰ In series of articles in the *Wall Street Journal* Mike Leavitt, the conservative Republican governor of Utah was characterized as a proponent of big government and high taxes. The *WSJ* went so far as to call him "Al Gore's Secretary of Treasury", the "Grinch" and the "Democrats point-man," because he supported developing a process to collect the use tax.

result is a situation of measurable and direct costs being measured against diverse benefits that are generally unmeasurable. The public finance literature offers a theme that some degree of equivalence is needed between the cost of providing public services and the value citizens receive from the services. Tiebout (1956) modeled individual behavior when the equivalence ($\text{Benefits} = \text{Cost}$) is not achieved. His model suggests that lacking general correspondence between the price of the local public goods and the marginal benefits provided by the public goods individuals will exit a community. This is the type of situation in which firms would not be motivated to join the tax club.

Vendors, acting as free riders, may undermine voluntary compliance with the use tax. The problem could arise for the following reason. Even if the revenue from the use tax funds no public services, a vendor could achieve benefits if other vendors do collect the use tax. If some nontraditional vendors don't collect the use tax, while other vendors do collect the use tax, the noncollectors will still benefit. If a sufficient number of firms comply with the use tax the political and revenue pressures to mandate compliance diminish. Noncomplying vendors would feel less pressure to comply and thus benefit from the compliance of others. The problem of free riders may not be a fatal flaw, but it does raise serious concerns.

Consider the situation of a water shortage in a community water system. The first question is whether a system to voluntarily restrict water use will work. We might expect people to comply voluntarily in a small community if noncompliance among neighbors were obvious for everyone to see, or the decline in stored water were obvious; lawns either stay green or become brown. Even in small communities we would not likely find complete cooperation if noncompliance were hard to monitor, as would be the case if the majority of water were used within the walls of residential home. Water users want to continue with their present behavior, hoping others will change their behavior. In fact, unless water is metered, it is reasonable to expect many water users to continue to consume water as if there was no issue about declining amounts of water. This situation is not too dissimilar from decisions to comply with the use tax. If others cooperate I can continue my behavior and benefit from others actions.

Lost Sales

Perhaps the most significant cost a vendor might encounter if they collect use tax is a reduction in sales. Evidence suggests that consumers are aware of the cost advantage of purchases when no use or sales tax is collected. Customers in several surveys believe that collection of a tax would distract from their use of the Internet to make a purchase. A survey conducted by the Center for E-Commerce at the University of California, Los Angeles found that over 45 percent of the respondents indicated they would not complete a purchase if they were required to pay the sales tax (UCLA, 2000). Goolsbee (2000), using data from 1999, concluded that collecting the use tax could reduce sales by as much as 24 percent. He also reports that consumer use of the Internet increases in states with higher sales and use tax rates (Goolsbee, 2001)¹¹.

Survey work by the accounting firm Arthur Andersen finds that Internet shoppers are put off by procedures that require more than a few steps or “clicks” to complete a sale. Unless a system to collect the sale tax over the Internet is carefully designed, the procedures to calculate the use tax could become a deterrent to sales.

Another factor is the growing use of third-party vendors on the Internet. More and more markets have developed an electronic search engine or E-commerce *bots* that provide consumers with information about price of products, quality of products, availability of products and shipping charges of products and whether or not the use taxes are collected (Segev, Gebauer, and Farber, 1999). Bots have been developed for virtually every field of consumer products and are now found in industrial B2B markets like metals, computers, chemicals and semi-conductors. The Internet gives customers the means to examine products and services easily and compare prices if use taxes are being charged.¹²

Separate Entities and Use Tax Collection

Many business firms have adopted legal but extraordinary means to avoid paying state and federal corporate or business activity taxes. Firms create affiliate entities that

¹¹ In a survey of consumers by the National Association of Counties, (2000) 65% percent of those polled felt it was unfair to not collect taxes from out-of-state vendors.

¹² Even without E-commerce competition is a big issue for many traditional retailers and their suppliers. For example, grocery chains and the manufactures that supply them have seen profits reduced and prices increasing slower than the price index. One aspect of the Internet is that it is giving customers the ability to interact directly with the supplier and actually become part of the production process. Dutta and Segev (1999) describe the Internet as a shared global market place.

allow the sheltering of taxable income obligations. These practices are now occurring around the use tax. The process operates as follows. A parent firm with nexus or a physical presence in a state creates an affiliate entity or subsidiary that has no physical presence in a state. By creating the affiliate separate from the parent, the firm avoids nexus within a state for the affiliate. The affiliate completes sales transactions using indirect methods like the mail, phone system, or the Internet; and the products are delivered by a third party that is not associated with either the parent firm or the affiliate firm. The vendor is not only sheltering income but also its activities. Once the separate entity is created a vendor argues that it has no responsibility to collect the use tax that is legally due from the consumer.

Typically, a parent firm has a number of retail location or service centers in the various states that create nexus, but the affiliate undermines the assumption of nexus. Examples of vendors employing this practice are easy to find; include household names such as Dell, Gateway, Wal-Mart, Saks Fifth Avenue, Borders, Barnes and Noble, and Nordstrom's. Barnes and Noble is an interesting example of how closely related the parent firm is to the affiliate entity. The Board of Barnes and Noble and its dot.com affiliate are virtually overlapping. They share the same Chair of the board and have multiple common board members (New York Times, 2002).

The legal issues around this form of organization – that is will it succeed in protecting the firm from use tax nexus – are evolving. Cases in state courts in Tennessee and Illinois have ruled against giving affiliate entities a pass on the responsibility to collect the use tax. However, as Frieden (2000) notes, in both of these cases nexus was established because of business practices that created nexus and were not related to the practice of creating affiliate entities, e.g., in-state solicitation by the parent firm and visits by out of state officers to the affiliate entity. In a series of other state cases from Ohio, Pennsylvania, California and Connecticut, where the courts have validated the concept, affiliate entities do not have a responsibility to comply with requests for use tax collection.

At the present time the U.S. Supreme Court has not directly responded to any of the state use tax cases. Vendors must decide if they are comfortable in developing a marketing strategy based on using affiliate entities? If firms believe there is market

advantage and tax safety under this approach affiliate entities could become a significant challenge to both voluntary and mandatory use tax compliance. The challenge comes in a variety of ways. Two issues are particularly important. First, if existing brick and mortar vendors can create dot.com affiliates, avoid the use tax, and operate like their dot.com competitors, we expect them to do so. The obvious result is lost use tax revenue.

However, the second challenge is perhaps more serious. Traditional vendors want a level playing field, and if they must collect the sales tax they naturally want out of state vendors to collect the use tax. State officials are hoping that traditional vendors will provide political support in their efforts to change laws and administrative policies relate to use tax collection. An argument used to get states to participate in the STTP process is the current practice places traditional vendors who collect the sales tax at a disadvantage. For example, this argument was used in Kansas (Cartwright, 2001) and in Ohio (Wheat, 2001) during the debate over the adoption of the STTP. However, if affiliate entities become strategic successes, there is less hope that traditional brick and mortar firms will become politically involved in the processes to change the current compliance practices.

Business Activity Taxes

A concern for nontraditional vendors who might consider collecting the use tax on a voluntary basis is the potential that compliance could create nexus for other business taxes. If a vendor decided to collect the use tax it would need to register with the state revenue department. At issue is the concern that such actions could be construed as establishing nexus for other business activity taxes such as a state corporate income tax or a state corporate franchise tax. The specific issue is if use tax compliance would void the current protection out of state firms now have under federal law (*P. L. 86-272*). The gist of 86-272 is to provide protection from the state corporate income tax if the nexus a firm has in a state is limited to the solicitation of orders and any shipment comes from out of the state (McLure, 2000). This law is a key part of tax planning and the potential loss of its protection under a voluntary process is a concern to a number of firms (Jones, 2002).¹³ During several of the processes listed in table one public officials proposed designing a *firewall* that would protect firms from achieving nexus for other taxes in they gave up

¹³ The practice of seeking ways to avoid paying direct business taxes has been highlighted by the current Enron collapse. The *New York Times* reports that Enron created hundreds of off-shore affiliate entities in order to avoid tax obligations. The use of Bermuda as a shelter for direct business taxes is also growing.

nexus protection for the use tax. However, companies involved in these processes did not feel a firewall would be sufficient protection. The current STTP proposal promises that collecting the use tax will not create nexus for other taxes.

Nature of the Goods and Services Sold

Use tax compliance will also be a function of the goods and services offered by firms. It is no surprise that are goods and services that are more likely to be successful when offered over the Internet and others are likely to face considerable probability of failure. There are several attributes of a product that help to predict the success of a good or service being offered over the Internet. When the process of choosing a good or service is relatively simple the source of the purchased item is driven by convenience and price. For such products the purchase does not require a physical examination. Neither does the selection depend on personal interaction or direction when making the purchase decision. These products are likely candidates for success using the Internet as the marketing, purchasing, and distribution systems. Examples include books, music, toys, software, personal computers, general office supplies and a variety of industrial goods and services (Dyer and Hesterley, 2002). Internet market success is even more likely when a product can be delivered in a digital format. Companies selling such products will likely be pure plays, or firms only using E-commerce to sell their goods and services. There is little indication that such firms would need to partner with a brick or mortar firm to have access to the market place. For such firms physical nexus seems remote as does volunteering to collect a use tax.

Other goods and services often benefit from a physical examination before a customer will feel comfortable enough to make a purchase. At least in the United States, automobiles and home furniture are examples of these products. Financial planning and personal insurance may also be products that require a face-to-face contact in order to complete the transaction. These types of goods and services will typically need to take a physical location or complementary assets in order to succeed. This needed relationship to a “showroom” partially explains the emergence of “click and mortar” alliances. These firms may establish nexus, but the establishment of an affiliate entity may remove the responsibility to collect the use tax.

The process of delivering a finished good or service also has an effect on how the good or service is sold. If the process or supply chain of moving the good from supplier to consumer is complex before the final purchase is completed, it is less likely that the good will be sold over the internet. This is especially true if the value added, or adjustments to the product at the various nodes of the supply chain, depend on decisions made after down-line customers send purchasing signals. Figure one offers a simple diagrammatic of the potential trade-offs between how a good is marketed and the uniqueness of the product and the steps in the value chain.

[Insert Figure 1 Here]

Goods and services found in the shaded area in the left-hand corner of figure one are sold by firms in which we expect to see E-commerce sales and distribution models succeed. Because there is a modest requirement for fixed investment, it is reasonable to assume that a number of firms will enter the market to sell the goods found in the shaded area of figure one. An important aspect of such a market, i.e., many sellers and buyers, is that price, ease of shopping, and product delivery are all critical steps in the purchase decision. An important way vendors compete in this type of market is through prices. Goods and products sold under such conditions have the characteristics of a commodity and even a small price increase could undermine the competitive position of a firm. The point is obvious: voluntary compliance with the use tax may simply not make sense for many of the firms most likely to succeed in the E-commerce market place. Price is too important. Manbridge (1998) suggests that American corporations will make contributions to the public good, but do so when market conditions (informal monopoly or oligopoly) allow them to pass the costs forward to the consumer.

Nexus

History is the final reason we wonder about the success of voluntary use tax compliance. Nontraditional vendor firms have fought a variety of administrative, political, and legal battles over nexus. They have prevailed in two extensive court battles with states to avoid collecting the use tax. The Supreme Court decisions are the law of the land and have prevented vendors from any requirement to collect the use tax if nexus is not established. It is hard to imagine that a vendor or group of vendors that have been

part of the long conflict to avoid the burden of collecting the use tax would easily give up the protection they have earned. In essence, states are asking nontraditional vendors to concede their nexus protection after the Supreme Court has clearly been on the side of the vendors. Further, giving up their two sure victories may compromise future battles over other tax and nexus questions.

Can the States Pull It Off?

Voluntary compliance issues may be mute if the states are unable to accomplish the task of simplifying their sales and use tax systems. While there has been considerable success in getting states to undertake the task of process and system simplification, a great deal remains to be accomplished (McLure, 2002). The states must overcome serious obstacles. First, the simplification and reengineering of the sales and use tax process is not a minor undertaking. Multiple states using hundreds of tax administration protocols must concur with the changes. Second, interstate cooperation is not easy to find, and on tax issues, states often directly compete with each other (Kenyon and Kincaid, 1991).

On the plus side of this issue are occurrences of multistate cooperation to improve and rationalize state tax systems. The Multistate Tax Commission (MTC) is an example of a compact between states that has facilitated uniformity between the states in terms of audit coverage and administrative performance. Of course, for some members of the business community the MTC illustrates why cooperative tax administration should be avoided. And within the member states of the MTC there is disagreement over strategy and tactics (Brunori, 1999). The recently adopted multistate charter on collecting the motor fuel tax from the interstate trucking industry is an example of efforts to improve the performance of the tax system in fifty states by streamlining the administration of the tax. Further, the adoption of the motor fuel tax program has been welcomed by the trucking industry (Utah State Tax Commission, 1999).

In addition to the issue of taxes and looking at other areas of interstate cooperation, some states are looking out for their mutual interests. States have shown that when they share a mutual interest, they are willing to cooperate in legal cases before the U.S. Supreme Court. Since the mid-1980s the states have filed a series of *amicus curiae* briefs with the Court. The briefs are written to reflect the combined position of the participating states. This practice offers evidence that states can cooperate, but it also

offers a warning. States generally file briefs only when the issues are narrow and technical. In more complex cases involving issues where policies and politics may differ between the states, the briefs are absent. (Lavery and Palmer, 2001).

It is naive to assume that the states uniformly agree on the goal to simplify the sales and use tax administrative processes. There are differences among the states. The absence of participation by important states like California, Massachusetts, and New York is a challenge to the STTP process. In the long run such states will need to join with the STTP charter states, or it will be compromised. The ability to forge an alliance with the participating states to change the sales and use tax also depends on a variety of internal political issues. One interesting issue is how state legislative leaders will respond relative to the position of the governor. During the initial planning stages of the STT project, the National Conference of State Legislators offered a substitute proposal that diluted the proposed STTP document that had been drafted by the National Association of Governors, the Federation of Tax Administrators, and the Multistate Tax Commission. It appeared to some that the legislative leaders were less willing to confront the initial challenges to the proposed in the STTP proposal. The NCSL substitute differed from the NGA proposal in several significant ways. The NCSL proposal did not require states to adopt a uniform set of definitions for the sales and use tax base; it also is much less precise on the issue around sourcing, that is, will the tax be due at the point of purchase or at the point of delivery and it did not require uniform rules for bad debts and rounding of tax rates (Hardsty, 2000). If this instance can be generalized, it suggests we should expect disagreement between executive and legislative bodies over the issues.

It may turn out that political affiliation will become a roadblock to gain cooperation. There are vast political differences between each of the fifty states. In some states one political party dominates the state, and in other states there is balance between the two major parties. There has been a clear difference between the two national parties on votes over the Internet Tax Freedom Act. In the first extension of the Internet Tax Freedom Act, the bill was opposed by only eight Republicans in the U. S. House of Representatives. The vote in the Senate also reflected a bright line test between Democrats and Republicans (National Retail Federation, 2000). However, the most

visible supporter of the STTP process has been Mike Leavitt, Republican Governor of Utah.

Economic Development and Fiscal Federalism

State and local governments have been competing for new businesses by offering a variety of tax and fiscal incentives (Oates and Schwab, 1988). The scheme used by state and local governments to compete for business has become a policy art form. The practice is to try to provide desired public services to relocating firms and at the same time minimize the tax costs confronting the firms. General tax holidays, industry- or firm-specific tax exemptions, and training programs for company employees are common tax and economic development practices. Some suggest that these policies have created a race to the bottom for both tax bases and tax rates. This race may or may not be taking place; for example, Oates (2001) is not very convinced by the evidence of a race to the bottom. Nevertheless, at least those states that have become a haven for nontraditional vendors would likely oppose a process that may diminish the market advantage enjoyed by the firms they host.

Importance of the Sales Tax to State

The fiscal importance of the sales tax may have a role in the willingness of a state to compromise its current tax system and conform to the recommendations proposed by the STTP. It is difficult to say how a state that relies heavily on the sales and use tax might respond. One possibility is that if sales tax revenue is important, a state will be unwilling to risk changes in its current system. State leaders may conclude that initial revenue and political implications are too drastic or uncertain to be unacceptable. Another possibility is that because the sales tax is so important, state leaders will recognize a need to adopt the STTP proposals to insure that the revenue from the sales tax will continue. It also possible that some states will not adopt the proposals but hope that other states adopt the recommendations. Such states may assume that if a sufficient number of states follow the STTP proposals, a network externality will develop and eventually benefit them.

Importance of Sales Tax to Local government

A key part of any cooperative outcome is how local governments are treated. As noted, the proposed STTP process would require more notice to national vendors about

rate changes and perhaps even a commitment to limit the number of taxing jurisdictions that are using local option use taxes. However, there is risk with this approach. This solution will make voluntary compliance more difficult to sell. Vendors can continue to report that compliance with the use tax requires rate information on over 7400 state and local taxing jurisdictions. The point is that even if the states can agree on a process to limit changes in the local option sales tax, it may not be enough. Nevertheless, state and local officials have demonstrated a very limited desire to do more than is currently being offered. There are also states like Colorado and Louisiana where sales and use taxes are collected locally and those states have been reluctant to grant to their respective state revenue departments the authority to collect the use tax.

The other difficult local issue is found in states where local governments have some control over the tax base. The NGA would prefer a uniform tax base in each state, but the NCSL suggests that current policies should continue. Again, if the base issue is left unchanged it becomes a focal point for vendors that oppose complying with the use tax. It is easy to report how difficult it is to collect a use tax successfully when both the rates and the bases are different within a state. In spite of the difficulty this presents to simplification, many on the state and local government side remain unwilling to give up the autonomy.

Technology

The development of technology to administer and comply with the use tax seems to have support from both vendors and tax administrators. However, the issue around the development of technology demonstrates the problem that states face. During the mid- and late-1990s proposals were made to use technology to lead the effort to simplify tax compliance. The technology would be used to monitor sales by vendors and would identify the taxability of the products purchased as well as the point of purchase or location of the buyer. But rather than helping resolve the problem, the discussions of technology actually derailed the progress that had been made. Although difficult to verify, it appears that some groups and individuals who have always opposed collecting the use tax publicly suggested that the compliance technology associated with the use tax would be an invasion of customer's privacy. Of course, these critics had a point, because the technology would have allowed an agent of the government or the government to or a

detailed record of the purchases a consumer made. Newt Gingrich (2000) made the following point in an op ed article published in the *Washington Times*:” Protecting consumer privacy is best accomplished by making the federal ban on discriminatory e-commerce taxes permanent. Any effort by government to control the Internet will inevitably require invasive monitoring and should be considered an assault not only on the medium but also on business and personal privacy” (3)¹⁴. These groups also argued that the technology would not work. A lobbyist for the software and nontraditional vendor industries labeled technology-driven use tax software “vaporware” (Jones, 2000).

Incentives Needed to Make Compliance Work

If the participants involved in the STTP process are able to develop a simplified system that most find acceptable, the basic question remains: Will nontraditional vendors voluntarily collect and remit the use tax to states and localities? In order to answer that question with any certainty we need to consider the motivations of the vendors. There are a variety of views both on what motivates a firm and what should motivate a firm. Essentially, two decision criteria face a firm: a normative basis—the firm collects the use tax because the society is better off if it does or it is perceived as being a better firm; or a purely calculative or cost-benefit basis—the firm complies because it contributes to the bottom line. In an influential article, Frideman (1970) argued that firms should be driven by the bottom line and decisions that detract from the bottom line are misguided. His view of corporate social responsibility is that if the firm makes money, it is fulfilling its responsibility. Without careful design the STTP program will not pass the Friedman doctrine. Others (Gibbons and Page, 1998) see corporate responsibility as more involved than just the return investment or capital. In their view, corporations may base decisions on a variety of criteria. Using their logic, other reasons firms might consider voluntary compliance is that it may contribute to the firm’s reputation (Rindova and Fombrum, 1998), or complying may contribute to the overall social acceptance or legitimacy of the firm (Suchman, 1995). Greer and Downey (1982), examining studies on compliance

¹⁴ Grover Norquist, a lobbyist funded by the Internet firms, wrote the following, “The proposal put forth by the National Governors Association, which would enlist ‘trusted third parties’ to serve as interstate tax collectors, provided a prime example of how state and local politicians will sacrifice taxpayers privacy in their quest for higher taxes (Norquist, no date).

decisions of four federal agencies, OSHA, EPA, FTC and EEOC, concluded that it was not possible to articulate the motive, cost-benefit normative, that drove the decisions made in these studies.

In this paper, we take the position that there is a better chance of success if the STTP assumes that firms make decisions on a cost-benefit basis. A primary reason for our assumption is that corporate tax departments are traditionally considered cost or perhaps expense centers in which the motivation is the minimization of both tax and operation expenses. We also adopt the views of Jensen (1998) that even optimal decisions in organizations face opposition from within and outside the organization. Thus efforts to make a tax department part of the firm's overall strategic focus will not be easily accomplished. By making this assumption, STTP proposals can be evaluated by asking if they will lower the cost of compliance or even offer an opportunity to add to a firm's bottom line. With this in mind, we offer the following.

Audit Relief

Tax audits are not fun. They require allowing government representatives to have access to sensitive financial information and strategic processes. They also require firm time and resources. Audits can be conducted by the individual states, the Multistate Tax Commission, and even by local governments that might be concerned they are not getting their appropriate share of revenue from a tax. On average large firms can expect seven tax related audits every year and the number of audits is growing. And as noted by (Andreoni, Erard and Feinstein, 1998), tax audits are expensive and time-consuming, and impose a significant burden on businesses. Unfavorable outcomes include the payment of back taxes, penalties, fines, and frequent legal battles that drag on for many years.

Few audit processes are more difficult for a firm or corporate tax department to deal with than use tax audits. Use tax audits require the storage and retrieval of information of transactions that cover thousands of transactions that are "consummated" in thousands of taxing jurisdictions. Large and small firms that engage in multistate B2B transactions are asked to verify that they have either collected the use tax that is due, or that the firm which purchased the good has paid the use tax to the appropriate taxing jurisdictions. In addition, the raising of issues of use tax compliance has implications not only for the firm being audited but also for other firms doing business with the audited

firm. Inconsistencies in information found at a vendor firm can trigger audits at firms that purchase goods from the firm being audited. It takes little imagination to conclude that a firm that is audited because of the activity of a supplier is less likely to continue to use the firm that “triggered” the audit.

Without question, some firms have attributes that result in frequent audits. Size, type of activity, past audit findings are all part of the audit selection decision (Murray, 1997). Some of the attributes, revenue size and services sold, are hard for a firm to control. As a result, tax audits are just part of being a big firm. But more than size or revenue seems to matter in a number of audit selections. For example, firms that have significant differences between their financial books and their tax books are subject to more audits. Mills (1998), examining the frequency of IRS audits for over 1500 firms over an eight-year period, reports that firms must consider the trade-off from a higher reported financial income and the cost and consequence of a tax audit. But our key point is this: If a firm can be audited for “bad” behavior, can it expect to not be audited for “good” behavior?

Offering a firm the potential of latitude with respect the frequency and extent of the audit is an incentive that firms should find attractive. Audit relief could be offered as either a carrot or a stick. Given the general focus of the STTP approach, a carrot appears to be the most consistent offering. The carrot, is that firms who voluntarily comply and collect the use tax could avoid or reduce audits of sales and use tax accounts. This incentive has been raised in several proposals. Audit protection would likely be driven by a firm’s commitment to have its use tax compliance system validated by a state revenue department. If a firm had its own compliance system certified, or engaged an outside certified compliance company, it would be protected from audit exposure. Any audit would be conducted at the compliance firm; and discrepancies, including penalties and interests, would be an issue for the outside party firm.

Because a use tax audit can create issues for a vendor’s customers a program that protects the vendor from audit would also offer some insurance to the clients. This protection may become a marketing ploy that vendors could exploit as they sell products to out-of-state customers.

Profitability of the Activity

Part of the STTP process is to develop a compensation package for vendors who chose to comply with the request to collect the use tax. The STTP has developed a request for a study to estimate the cost of compliance associated with the sales and use tax. It is anticipated that the results from the study will be used to develop a fee that would be paid to firms collecting the use tax. Currently, 25 states allow firms to keep a portion of the sales tax they collect. These vendor discounts range from one-half of one percent of the taxes collected by a firm to three percent in some states. Many states that offer discounts for sales tax compliance do not extend the discounts to use tax collections. Depending on the level of the compensation, a vendor discount when coupled with reductions in audit exposure and simplification, might change the focus of the tax department from a cost center to a revenue center or even a profit center. If firms could be influenced to rethink how they view tax departments, the decision to comply voluntarily could be increased.

Uncertainty About Alternatives

If a firm, or group of firms, believes that noncooperation will result in undesirable outcomes, the inclination to comply should increase. There are two possible outcomes vendors would not be pleased with. One of the less desirable outcomes could be court action that runs counter to the *Quill* decisions and limits the protection offered by affiliate associations. If this were to happen, vendors would be expected to collect the use tax, but there would be fewer reasons for states to simplify their administrative mechanisms, base definitions, rate issues, or offer vendor discounts. Vendor firms could be compelled to comply without meaningful simplification. There are already examples of this practice. Grant (2002) reports that the current proposal from the European Union on E-commerce has raised concerns for American vendors. Under the EU proposal, European vendors would collect the tax at the firm level, but US companies doing business in Europe would collect the use tax based on delivery or destination. EU firms would have an easier time to collect the tax, and American firms would be placed at a distinct disadvantage. This is an example of a decision made without full consideration of the administrative or compliance difficulties.

The second concern is federal legislative action. Past attempts by Congress to resolve issues around the commerce clause and the use tax have been discussed before a Congress that did not believe the lost use tax revenue was substantial; and it was also a period of economic expansion when state and local coffers were growing. The revenue situation now has changed. Policy analysts are estimating significant revenue losses at the state and local levels under the current scheme, and these expected losses are coming when state and local revenues are also suffering from the current downturn. What may have been easy to dismiss in the past may now be difficult to ignore. Traditional vendors have also become more politically engaged in the current debate because they fear they are losing sales to nontraditional vendors. As *Vertex* reports, Forrester Research (2000) now argues that if the problem of the use tax is not resolved, congress will act because of the erosion of the sales tax base.

Litian and Rivlin (2000) and John Mikesell (2001), who is probably the most informed observer of the sales and use tax issues, suggest that if a solution is not found, not only will Congress act, it may impose a federally determined base and rates. Few students of fiscal federalism, and fewer governors, state legislators, mayors and corporate tax departments, would welcome that move (Wiseman, 2000)¹⁵.

Business Advantage to Establish Nexus

Firms may conclude that establishing a physical presence or nexus in a state is an important element in the marketing strategy of the firm. Firms could also decide that there are disadvantages associated with an affiliate entity. Nexus could create a number of advantages. For example, Nexus would allow the development of traditional stores to handle returns and service issues or to allow customers to come in and compare products. It may also mean that representatives of the firm are able to visit a state to solicit business and deal with service issues. It may also mean that the affiliate firms may decide it is to their advantage to use the retail location of the parent company to help market the products they sell. A physical experience with a product is important in many purchase decisions (Bakos, 2001). A customer unhappy with a book or CD could return it to the local store and that store would now be happy to receive the return or service the product.

¹⁵ States also face uncertainties. In 2000 proposals were made in the U.S. Senate and House of Representatives to prohibit the collection of sales and use taxes on all Internet sales (Nicholson, 2000).

The return problem for e-commerce vendors is serious. There are costs of billions of dollars in merchandise and resources (Saliba, 2001). The firm may also find it is easier to use the states legal system to enforce contracts.

Public Image

A vendor might desire to improve several types of public image. A firm may decide that it will generate favor with state and local officials if it decides to comply with the request to collect the use tax. Frankly, this does not seem to be much of a reason to comply. Firms that avoid paying taxes generally do not suffer unfavorable market or political consequences. However, the B2B firm's image with customers might benefit from use tax collection if it results in less audit exposure for its clients.

Will It Succeed?

In our view the probable success of the STTP proposals and voluntary compliance boils down to the expected net benefits vendors can achieve under the process. The level of benefits a vendor gains has much to do with the nature of the vendor and the products and services they sell. Table 7 offers a matrix of combinations based on the size of the vendor and the degree of nexus achieved by the vendor. It also allows for three policy scenarios, the status quo, voluntary compliance, and imposition of a mandatory compliance requirement. Moving to the bottom of the table, we find firms that are now complying with the collection of the use tax because they have established nexus. These vendors would benefit if the current system could be improved. For these firms, the status quo and the mandatory systems are identical, but they should support the STTP process, because if its design is successful, it will lower their cost.

[Insert Table 7 Here]

The first three firms in Table 7 are firms that do not have nexus and do not anticipate having nexus. These would include the firms in the lower left quadrant of figure one. The status quo for such vendors is noncompliance. If the situation is going to change they would prefer the voluntary compliance system because it would come with simplification and vendor discounts. The danger, of course, is that a vendor will choose to comply but the competitors will not comply, and the complying firm will be at a price disadvantage. The question is then why such a firm would ever comply. They would comply if they felt that the possibility of a mandatory process was likely and by voluntary

compliance they could avoid the negative aspects of an expensive compliance process. These firms will make a decision on a variety of issues, but we identify three important drivers. First, what will the system do to the net operation costs? That is, firms will consider the net cost of complying and the size of the vendor discount. If the vendor discounts are of sufficient size to overcome the compliance costs, firms will obviously be more inclined to collect the use tax. Second, what will complying with the use tax, do to total sales? If a firm complies with the use tax will the increase in net price reduce its total sales? Finally, what is the risk associated with noncompliance? This last question is perhaps the most difficult for a firm to answer.

Consider the second set of vendors on Table 7. These are vendors that have evolved into an ambiguous nexus situation; perhaps they have actively developed affiliate entities or are acting in ways that may result in nexus. We assume that such vendors are not complying with the use tax. The question is whether they would be happier with a voluntary system or a mandatory system. Like the firms at the top of the table, they would prefer a simplified system, but they will not likely comply unless they are certain that complying will not erode their sales. The choice is thus again driven by the expectations of what compliance will do to sales, the net cost of compliance, and the degree of uncertainty associated with the status quo. Clearly, the mandatory system would be unpleasant for such firms.

[Insert Figure 2 Here]

Using a series of three parallel axes (see Figure 2), we illustrate a decision matrix that faces a vendor. Each line represents a distinct decision a firm will consider when thinking about complying with the use tax: the implications for cost, the implications for sales, and the degree of uncertainty. Assume that a vendor that has ambiguous nexus. Such a firm is not collecting the use tax, so that the current expense is close to zero on the net cost axis of table seven. The current behavior has some implications for sales, because by not collecting the use tax, sales are increased. However, the major problem for this firm is found on the third axis, or the axis representing uncertainty. Here the problem for the firm is relatively significant. By noncompliance, the firms face substantial uncertainty with respect to future audits, being forced to comply with an

unfriendly use tax system, and payment of back taxes. For this vendor, voluntary compliance may result in a higher net cost, some lost sales, but a substantial reduction in the current degree of uncertainty.

We hope it is clear that the degree of benefits that vendors can achieve by complying with the use tax depends on the situation of the vendor and the type of goods a vendor markets. We are now in the process of developing a series of simulations to try and answer the questions we have raised. We anticipate that our simulations will allow us to fill in the various cells in table seven with educated guesses about the likelihood of voluntary compliance. Our initial back-of-the-envelope calculations suggest that voluntary compliance may be more likely than many might suspect. If the simulations confirm our speculation, then the burden on the STTP participants to improve and simplify the use tax system is actually increased.

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Table 1

MAJOR USE TAX AND E-COMMERCE STUDY GROUPS

• Willis Commission (1965)	Mail-Order
• Advisory Commission on Intergovernmental Affairs (1986)	Mail-Order
• State Compacts (1988)	Mail-Order
• U.S. Treasury (1996)	E-commerce
• White House (1997)	E-commerce
• Tax Fairness Act for Mainstream America (1997) (1998)	
• Direct Marketing Association / State Revenue Departments (1998)	Mail-Order
• National Tax Association (1999)	E-commerce
• Organization for European Cooperation and Development (Ongoing)	E-commerce
• Advisory Commission on Electronic Commerce (2000)	E-Commerce
• Streamlined Sales Tax Project (Ongoing)	E-Commerce

Table 2

MAJOR USE TAX STANDARDIZATION AND SIMPLIFICATION TASKS
<ul style="list-style-type: none">• Administrative Procedures<ul style="list-style-type: none">→Standard forms→Standard rules for exempt sales→Simplified registration→Standard rules for bad debt • Sales and Use Tax Base<ul style="list-style-type: none">→Uniform set of definition • Sales and Use Tax Rates<ul style="list-style-type: none">→Standardize procedures to change rates→Timely notice of rate changes • Administration and Compliance Technology<ul style="list-style-type: none">→Computer software • Third Parties to Assist in the Compliance<ul style="list-style-type: none">→Certification of tax compliance agents→Certification of vendors tax compliance systems • Compensation Packages<ul style="list-style-type: none">→Determine appropriate vendor costs and compensate vendors

Table 3

STTP ADMINISTRATIVE SIMPLIFICATION

Vendor Identification and Registration: Develop a uniform vendor registration (e.g., a national multistate vendor registration form as an option in addition to state-specific forms).

Vendor Filing of Tax Returns: Develop uniform sales and use tax forms (which might reflect less frequent filing and tax remittance requirements); electronic filing of returns.

Bad Debt Concerns: Develop uniform state laws on bad debt deductions, i.e., in which a vendor is not fully compensated for a purchase due to insufficient check funds, terminated installment sales and other bad debts.

Vendor Direct Pay and Exemption Issues: Increased use of “direct pay” permits, i.e., where vendors directly remit use tax on their business purchase of goods and services; uniform resale exemption certificates and other exemption processes including establishing a reliance/indemnification standard for vendors who are provided with such exemption documentation.

Audit Process: Design an audit system that does not harm vendors who agree to voluntarily comply with the request to collect the use tax.

Table 4

**Sales and Use Tax Treatment of Selected Goods
That Can Be Sold by Remote Sellers – 1999**

State	Apparel	Grocery	Computer Software			Medicine		Newsprint	
			Food	Canned	Custom	Modified	Prescription	Nonprescription	Newspapers
Alabama				E	E	E			
Arizona		E		E	E	E			
Arkansas						E		E^r	E^r
California	a	E		E	E	E		s	s
Colorado		E		E	E	E		E	
Connecticut	b	E				E		E^t	E
District of Columbia		E				E	E	u	
Florida		E		E	E	E	E	E^v	E^v
Georgia		E		E	E	E			
Hawaii						E			
Idaho	c			E	E	E		w	w
Illinois				E	E		o	E	E
Indiana	d	E		E		E		E	
Iowa		E		E	E	E		E	
Kansas				E	E	E			
Kentucky		E		E	E	E			
Louisiana						E		aj	
Maine		E		E	E	E		E	E
Maryland		E		E	E	E	E	x	
Massachusetts	e	E		E	E	E		E	E
Michigan		E		E	E	E		E^y	E
Minnesota	E^f	E		E	E	E		E	E^z
Mississippi						E		E	E
Missouri				E		E			
Nebraska		E				E		E^{aa}	E
Nevada		E		E	E	E		E	
New Jersey	E^g	E		E	E	E	E	E	E^{ab}
New Mexico						E		E	
New York	h	E		E	E	E	E	E	E
North Carolina				E	E	E		E^{ac}	ac
North Dakota		E		E	E	E		E	
Ohio		E				E		E	E^{ad}
Oklahoma				E		E		E	E
Pennsylvania	E^i	E		E	E	E	E	E	E
Rhode Island	E^j	E		E		E	E	E	E
South Carolina						E		E	
South Dakota						E			
Tennessee	k					E		E^{ae}	E

State	Apparel	Grocery	Computer Software			Medicine		Newsprint	
			Food	Canned	Custom	Modified	Prescription	Nonprescription	Newspapers
Texas	^l	E				E		<i>E^{af}</i>	E
Utah				E	E	E		E	
Vermont		E		E	E	E		E	
Virginia	^m			E	E	E	E	<i>E^{ag}</i>	<i>E^{ag}</i>
Washington	ⁿ	E		E	E	E		E	
West Virginia								^{ah}	
Wisconsin		E		E	E	E		E	<i>E^{ai}</i>
Wyoming				E		E			

^a California exempts new clothing to nonprofits for elementary students and used clothing sold by certain thrift stores.

^b Connecticut exempts employees safety apparel; clothing and footwear less than \$50, but no athletic or protective items.

^c Idaho exempts clothing and footwear purchased by nonprofits to provide free clothing

^d Indiana exempts protective clothes for contaminant production and prevention.

^e Massachusetts exempts up to \$175 for any article of clothing or footwear, excluding athletic activity and protective ware.

^f Minnesota taxes athletic, sporting, recreational items, jewelry, and articles made of fur.

^g New Jersey taxes clothing and footwear with fur or pelt at chief valued component and athletic goods and equipment.

^h New York exempts clothing articles costing less than \$110, articles less than \$500 the third week in January 1999, and certain safety apparel.

ⁱ Pennsylvania taxes fur articles, ornamental, formal ware, and sports clothing.

^j Rhode Island taxes athletic or protective use apparel and footwear.

^k Tennessee exempts used clothing sold by certain profits.

^l Texas exempts clothing used directly in production and with a useful life of 6 months.

^m Virginia exempts safety apparel furnished gratuitously by manufacturers to production line employees.

Source: GAO 2000

Table 5

VARIATIONS IN LOCAL SALES TAX RATES (ALL STATES)

State	Range of Combined Rates	State Rate	County Range	City Range (incl. Ind. Cities)	District Range	Number Of Different Rates	Notes
1 Alabama	4.00-11.00	4.00	1.00-4.00*	1.00-5.00*		13	
2 Alaska	1.00-7.00*		1.50-5.00*	1.00-7.00*		8	No State Sales Tax
3 Arizona	5.00-8.00	5.00	.50-1.00*	1.00-3.00*		23	
4 Arkansas	4.625-8.125	4.625	.25-2.00*	.25-3.00*	1.00*	13	
5 California	7.25-8.50	6.00	1.25		.125-1.25*	8	
6 Colorado	3.00-9.50	3.00	.40-4.00*	1.00-5.50*	.80*	44	
7 Connecticut	6.00	6.00				1	
8 Delaware							No Sales Tax
9 District of Columbia	5.75	5.75				1	
10 Florida	6.00-7.50	6.00	.50-1.50*			5	
11 Georgia	5.00-7.00	4.00	1.00-3.00		1.00*	3	
12 Hawaii	4.00	4.00		1.00-3.00		1	
13 Idaho	6.00-8.00	5.00		1.00-3.00		3	
14 Illinois	6.25-9.00	6.25	.25-1.00*	.25-4.25*	.25-.75*	12	
15 Indiana	5.00	5.00				1	
16 Iowa	5.00-7.00	5.00	.50-2.00*	1.00*		4	
17 Kansas	4.90-7.65	4.90	.50-2.00*	.25-2.00*		15	
18 Kentucky	6.00	6.00				1	
19 Louisiana	4.00-10.75	4.00	2.00-5.00*	.30-5.00		25	
20 Maine	5.50	5.50				1	
21 Maryland	5.00	5.00				1	
22 Massachusetts	5.00	5.00				1	
23 Michigan	6.00	6.00				1	
24 Minnesota	6.50-7.50	6.50	1.00*	.50-1.00*		3	
25 Mississippi	7.00-7.25	7.00		.25*		2	
26 Missouri	4.225-8.225	4.225	.50-2.25*	.50-3.291*		34	
27 Montana							No Sales Tax
28 Nebraska	5.00-6.50	5.00		.50-1.50*		4	
29 Nevada	4.25-7.25	4.25	2.25-3.00	2.75*		4	
30 New Hampshire							No Sales Tax
31 New Jersey	6.00	6.00				1	
32 New Mexico	5.125-6.938	4.50-5.00/a/	.0125-1.313	.50-2.438		23	/a/ Partial County over-ride
33 New York	6.00-8.50	4.00	1.50-4.25*	1.00-7.00	0.25	9	
34 North Carolina	6.00-6.50	4.00	2.00-2.50			2	
35 North Dakota	5.00-7.00	5.00	.50*	1.00-2.00*		5	
36 Ohio	5.00-7.00	5.00	.25-2.00*		.25-1.00	8	
37 Oklahoma	4.50-9.75	4.50	.20-2.00	1.00-5.00		41	

State	Range of Combined Rates	State Rate	County Range	City Range (incl. Ind. Cities)	District Range	Number Of Different Rates	Notes
38 Oregon							No Sales Tax
39 Pennsylvania	6.00-7.00	6.00	1.00*	1.00*		2	
40 Rhode Island	7.00	7.00				1	
41 South Carolina	5.00-7.00	5	1.00-2.00			3	
42 South Dakota	4.00-6.00	4.00*		1.00-2.00*	4.00*/b/	3	/b/Indian reservations-supercedes state rate
43 Tennessee	7.50-8.75	6.00	1.50-2.75	.25-.75*		6	
44 Texas	6.25-8.25	6.25	.80-1.00*	.50-2.00*	.25-1.00*	8	
45 Utah	6.00-7.75	4.75	1.00-2.00	1.00-3.00*/c/	.25*	10	/c/City taxes may over-ride county taxes
46 Vermont	5.00-6.00	5.00		1.00*		2	
47 Virginia	4.50	3.50	1.00	1.00/d/		1	/d/Independent cities or counties
48 Washington	7.00-8.60	6.50	.50-1.50	.50-1.70*	.20-1.00*	12	
49 West Virginia	6.00	6.00				1	
50 Wisconsin	5.00-6.00	5.00	.10-.60*	0.500		5	
51 Wyoming	4.00-6.00	4.00	1.00-2.00*			3	

Source: *Vertex Sales Tax Rate Directory*, November 19, 1999

*There also are jurisdictions with zero rates

Table 6
State Revenue Losses as Percentages of Total State Taxes in 2011*

State	Trend Loss	Total E-Commerce Loss	New E-Commerce Loss	Combined Loss
	[a]	[b]	[c]	[d=a+c]
1st Quartile				
NV	6.81	9.46	5.03	11.84
TX	6.43	9.92	5.28	11.71
FL	6.68	9.1	4.84	11.52
TN	6.62	9.04	4.81	11.07
SD	5.44	8.56	4.55	9.99
WA	5.08	7.35	3.9	8.98
MS	4.8	7.58	4.03	8.83
HI	5.15	6.66	3.54	8.69
NM	4.74	7.09	3.77	8.51
SC	4.29	6.07	3.23	7.52
AR	4.01	6.22	3.31	7.32
GA	4.15	5.81	3.09	7.24
2nd Quartile				
AZ	4.1	5.9	3.14	7.23
LA	3.7	6.45	3.43	7.14
UT	3.94	6.01	3.2	7.14
OK	3.65	6.51	3.46	7.11
MI	3.63	5.68	3.02	6.65
MO	3.6	5.56	2.96	6.56
MN	3.62	5.48	2.92	6.54
KS	3.51	5.63	3	6.51
IN	3.58	5.47	2.91	6.49
WY	3.13	6.21	3.3	6.43
KY	3.5	5.45	2.9	6.4
3rd Quartile				
IL	3.42	5.45	2.9	6.32
ID	3.37	5.13	2.73	6.1
NE	3.24	5.29	2.81	6.06
IA	3.06	5.4	2.87	5.93
MD	3.4	4.66	2.48	5.88
WV	3.08	5.27	2.8	5.88
ND	2.93	5.54	2.94	5.87
OH	3.1	4.87	2.59	5.69
PA	3.13	4.76	2.53	5.67
CT	3.2	4.54	2.41	5.61
NJ	3.2	4.54	2.41	5.61
4th Quartile				
CA	3.19	4.52	2.4	5.59
RI	3.14	4.5	2.39	5.53
NC	2.83	3.98	2.11	4.94
VA	2.85	3.92	2.08	4.93
ME	2.8	3.91	2.08	4.88
WI	2.67	4.15	2.21	4.88
AL	2.69	3.95	2.1	4.79
CO	2.58	4.01	2.13	4.71
VT	2.49	3.49	1.86	4.34
NY	2.26	3.31	1.76	4.02
MA	2.27	3.27	1.74	4.01
DC	1.77	2.6	1.38	3.16
U.S. Average				
US	3.65	5.39	2.87	6.51

* Excluding states without sales tax (AK, DE, MT, NH, & OR)

Reference: Bruce, Donald, Bill Fox (2001), State and Local Sales Tax Revenue Losses from E-Commerce: Updated Estimates, Institute for State Studies, p. 12.

Table 7

Nexus Status	Size of Vendor	Compliance Status		
		Status Quo	Voluntary	Mandatory
Firms without Nexus	Large Firms with Sales in Many States			
	Small Firms, with Sales in Very Few States			
	Casual or Intermittent Sellers			
Firms with Ambiguous Nexus	Large Firms with Sales in Many States			
	Small Firms, with Sales in Very Few States			
	Casual or Intermittent Sellers			
Firms Seeking to Establish Nexus	Large Firms with Sales in Many States			
	Small Firms, with Sales in Very Few States			
	Casual or Intermittent Sellers			
Firms with Nexus	Large Firms with Sales in Many States			
	Small Firms, with Sales in Very Few States			
	Casual or Intermittent Sellers			

Figure 1

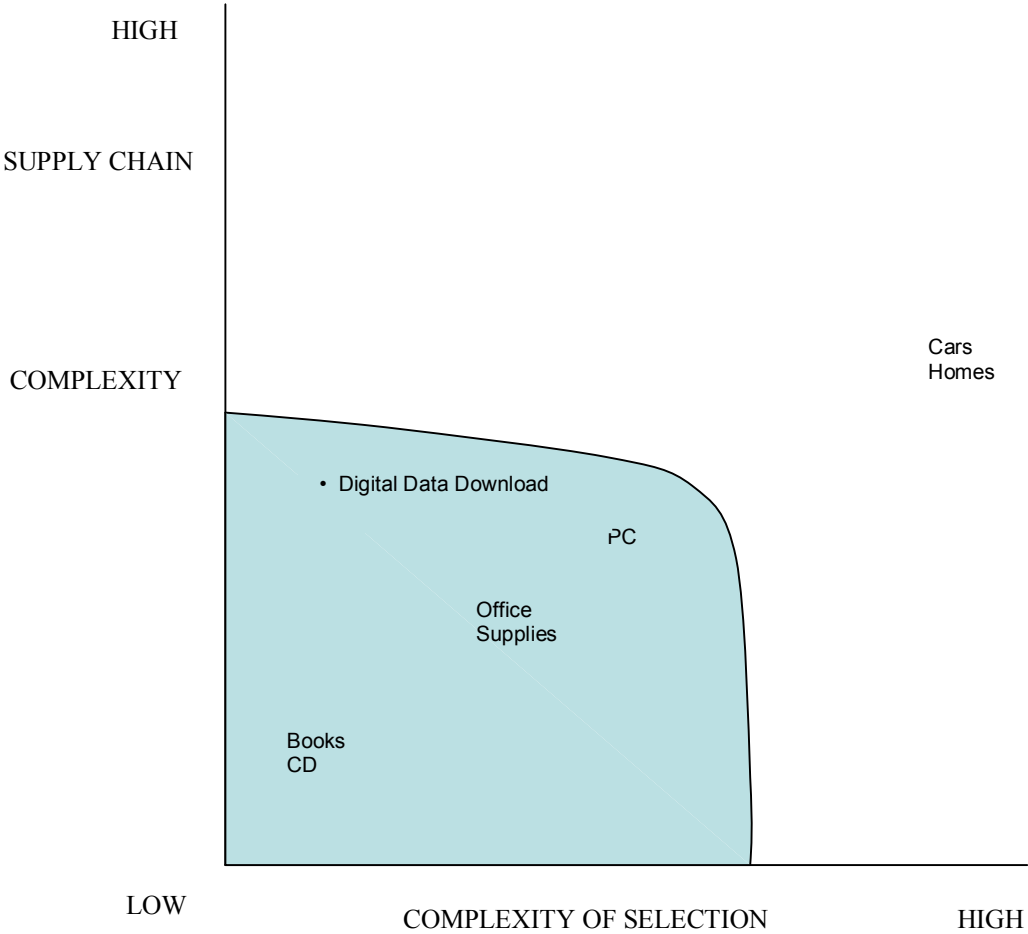


Figure 2

