Simplified Sales Tax:
Not So Fast – It's Not That Simple

The Big Picture. State governments have wrestled for decades with the challenges of collecting sales and use taxes on purchases from out-of-state retailers. What began with mail-order catalogs and telephone orders increasingly is moving online, so state tax collectors are now blaming e-commerce for uncollected taxes and the decline of Main Street businesses. But the tax loss numbers don't add-up. Main Street retailers use the Internet to compete against mass retailers, and a proposal to simplify sales tax systems is not so simple, after all.

The Background. The Streamlined Sales Tax Project (SSTP) began in response to a 1992 U.S. Supreme Court ruling for a catalog business that sold office supplies -- long before the Internet era had arrived. That ruling affirmed a 1967 decision that state sales tax systems are so complex that no retailer – whether storefront, catalog, or online – should have to collect sales tax for states where they have no physical presence. That left states with two options – radically simplify sales tax systems and come back to the Court for another look, or persuade Congress to force remote retailers to collect sales taxes, whether the systems are simple or not.

States pleaded for more taxing authority as the first dot-com bubble expanded, then cried louder as the U.S. economy slowed and spending by states outpaced revenues. State tax officials blamed e-commerce for their fiscal problems, and foretold huge future tax losses based on forecasts of growth in e-commerce. Five years later, state tax revenues have recovered.

The Numbers. The states, big box retailers and other advocates of the SSTP continue to use revenue loss estimates that just don't add up. They cite a 2004 University of Tennessee study that blames e-commerce for over $22 billion in lost sales tax during 2005. That figure was *half* as much as the same reseachers had forecast in a 2001 study. Their lower estimate recognized greater use tax compliance by businesses and the growing trend where big chains like Wal-Mart and Home Depot already collect sales tax on their online sales.

Moreover, the $22 billion estimate from the University of Tennessee is *four times* greater than it could possibly be, according to retail surveys by the U.S. Department of Commerce. Census Bureau surveys of 11,000 retailers show total retail e-commerce in 2005 of $70 billion, which could generate, at most, $5 billion in *total* sales tax. Even if *none* of that sales tax were collected, the loss would be just *one-quarter* of the Tennessee estimates.

The Congress. Competing estimates are only part of the debate over whether Congress should enact the provisions of the SSTP. While large, multi-channel retailers already are required to collect tax on their online sales, it would take a Congressional mandate to force all remote retailers to collect sales taxes and remit them to other states. Governors and state legislatures are pressing lawmakers in Washington for this new power of taxation, citing the progress of the SSTP and the urgency of states in "financial distress."

The Solution. SSTP would generate just a fraction of the states' forecast of new sales tax collection. And the compliance costs of SSTP—especially for small firms turning to the online channel—may outweigh the new tax revenue taken in by states. Instead of seeking a controversial Congressional mandate, sales tax states should:

- continue their efforts on simplification and streamlining;
- enforce better use tax compliance by businesses; and,
- ensure that multi-channel retailers collect remote sales tax as required under current law.