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THE WRONG PATH TO TAX REFORM:
How Parochial State Interests Undermined The Streamlined Sales Tax Project

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Mr. Chairman, Members of the Committee, on behalf of the Direct Marketing Association ("DMA") and its membership, I want to thank you for the opportunity to testify today. The DMA is the largest trade association for businesses interested in direct marketing to consumers and businesses via catalogs and the Internet. Founded in 1917, the DMA today has over 4,700 member companies in the United States and 53 foreign countries.

As both an attorney practicing in the area of sales and use tax law for more than 25 years and an instructor in Constitutional Law at Bowdoin College, I welcome the opportunity to discuss with you the important public policy implications associated with H.R. 3396, the so-called "Sales Tax Fairness and Simplification Act," and the threat it presents to core constitutional principles and America's ability to maintain its preeminent position in the field of electronic commerce.

H.R. 3396 presents a critical policy choice for Congress. Advocates of expanded state tax jurisdiction argue that the need for additional state revenue outweighs the constitutional protections for interstate commerce. Congress should be loathe, however, to set aside these constitutional standards, which have served the nation well for two centuries and created the largest and most vibrant economy in the history of the world. Expanded and overlapping state tax jurisdictions would seriously jeopardize the continued growth of electronic commerce in the United States and it would impede the access of small and medium-sized companies to a nation-

wide market. Indeed, the Internet has been an incubator for start-up companies and small businesses that have the entrepreneurial ambition and talent to market their goods and services throughout the country. Erecting a tax compliance barricade across the electronic highway is no way to spur economic growth or encourage small and medium-sized companies to expand their markets.

If Enacted, H.R 3396 Would Result In An Unprecedented Expansion Of State Taxing Authority

The Streamlined Sales and Use Tax Agreement (SSUTA) was drafted by state tax administrators for the express purpose of expanding the jurisdictional reach of state tax systems. H.R 3396 now seeks congressional complicity in this effort. The peculiar process by which the SSUTA came into being is a troubling one. Unlike the procedure customarily employed for the development of uniform state laws, which follows the time-tested route of hearings, deliberations, and drafting by the Commissioners on Uniform State Laws in the case of the SSUTA, state tax administrators in this instance chose to bypass altogether the Uniform Law Commission, whose membership consists of distinguished jurists, law school professors, government officials, and lawyers. Instead state tax officials chose to confer almost exclusively among themselves, sometimes even in closed sessions, to produce an agreement that contains scant contribution from the academic community and, most significantly, a rejection of almost all of the suggestions from that portion of the business community that would be most affected by the Agreement, *i.e.*, the direct marketing industry.

The Commissioners on Uniform State Laws have successfully produced over 200 uniform state laws in addition to their landmark work—the Uniform Commercial Code. A number of these uniform state laws deal with multi-state taxes (such as the Uniform Division of Income for Tax Purposes Act – UDITPA) and with electronic commerce (such as the Uniform

Electronic Transactions Act). If state tax officials had truly been interested in streamlining, simplifying, and making more uniform the crazy quilt of existing state and local sales and use tax laws, they would have requested that the Uniform Law Commission develop draft legislation for consideration and adoption by state legislatures. The fact that this traditional approach to developing uniform state laws was not employed is revealing of the true motives of state tax administrators. Their goal was neither simplicity nor uniformity, rather their objective was to obtain authority to export their tax systems across state borders and impose tax obligations on businesses that currently are constitutionally protected from over-reaching state tax laws.

The SSUTA is a document drafted by tax administrators for tax administrators, and, as might be expected, it resulted in little in the way of tax simplification. It has not reduced the number of sales/use tax jurisdictions in the United States, which currently number over 7,500. It has not reduced the number of state and local tax rates; indeed, it has authorized an increase in the number of such rates. It has not reduced the number of audits to which an interstate marketer would be subject (each state revenue department would still conduct its own independent audit). It has not produced a one stop/one form tax return and remittance system. It has not halted the explosion of confusing and totally discrepant sales tax holidays, which create mini-tax systems with separate rules of only several days' length. In fact, in certain respects, the SSUTA makes sales/use tax compliance more complex and confusing for both consumers and retailers.

Put simply, Congress should not endorse this misnamed exercise in state tax reform. Instead, this Subcommittee should urge state governors and the direct marketing industry to work together in a genuine and collaborative effort, under the auspices of the Uniform Law Commission, to standardize the administration of state tax laws. The Direct Marketing Association would be a willing and active participant in that process.

State Tax Administrators Have Grossly Over-Estimated Lost Sales/Use Tax Revenues.

The alleged tax revenue benefits of the SSUTA are illusory. SSUTA advocates have grossly exaggerated, by as much as 400 percent, the revenue "losses" states and localities have incurred as a result of the constitutional limitation on their ability to impose tax collection obligations on catalog companies and electronic merchants beyond their borders. The true figure is, in fact, only a fraction of one percent of total state sales and use tax collections. Recent analysis shows that the "lost" revenue for all current SSUTA Full Member States for 2006 totals only $145 million, not the billions of dollars claimed by state tax officials.

The claims of state government officials of enormous revenue "losses" because of uncollected sales and use taxes on electronic commerce are simply not supported by currently available data. Advocates of the SSUTA rely almost exclusively on predictions of lost tax revenue reported by two researchers affiliated with the University of Tennessee ("UT Study"). Their report, first issued in 2000, and then updated in 2001 and reviewed in 2004, is based on non-validated data collected by a private research firm. Actual data from the U.S. Department of Commerce Census Bureau 2007 E-Commerce Report analyzed by DMA Senior Economist Dr. Peter Johnson ("Johnson Study"), however, shows that on-line consumer sales growth has been much more modest than predicted in the UT Study, so that untaxed sales are (and will continue in the foreseeable future to be) much lower than assumed by state tax administrators.

Even more to the point, the UT Study also was founded on a number of faulty assumptions. The Johnson Study is illuminating in this regard (a copy of the study is attached). First, the vast majority of ecommerce – well in excess of 90 percent — is comprised of business–to–business ("B–to–B") transactions on which transaction taxes are either collected by vendors or remitted by companies that self-report the use tax. Most B-to-B transactions (88%) are

conducted via electronic data interchange ("EDI"), for which the sales/use remittance rate is effectively 100 percent. Even for the much smaller portion of B-to-B sales conducted over the Internet, a recent study by the Department of Revenue for Washington State indicates a sales/use tax remittance rate of 85 percent. Thus, the implication that states are "losing" a substantial portion of their sales tax revenues to electronic commerce is simply false, because the vast majority of e-commerce transactions are not consumer sales.

Furthermore, even as to business–to–consumer ("B–to–C") Internet transactions, state estimates of uncollected tax revenues are grossly inflated. Again, the UT Study over-estimated both total e-commerce growth and B-to-C growth, so state projections of gross revenue potentially subject to tax are far off the mark. Moreover, as the authors of the UT Study conceded in 2004, there are many more multi–channel retailers (*i.e.*, retailers with both retail stores, Internet websites, and, in some cases, catalog operations) that have commenced collection of sales/use tax on their Internet and other remote sales than originally estimated by the UT Study. In this regard, the perceived "problem" of catalog and Internet vendors not collecting use tax has proven to be largely self–correcting. As remote sellers grow, most of them embark on a multi–channel sales strategy, which includes opening retail stores and a corresponding decision to begin collecting state sales/use taxes voluntarily on all sales (including Internet sales) to residents in states where their stores are located.

Correcting for these and other flaws in the UT Study and relying on actual data from the U.S. Commerce Department, the Johnson Study shows that the amount of sales/use tax which remote e-commerce retailers could not be compelled to collect for all states is a mere fraction of the amount predicted in the UT Study. In total, combining B-to-C with B-to-B transaction data, "uncollected" sales and use taxes on on-line sales is best estimated to be only **0.2 percent** of all

state and local tax revenues for 2006. For the 15 states that are currently Full Members of the SSUTA, this translates into $145 million in total, not the many billions of dollars claimed by SSUTA advocates. (In fact, SSUTA Member States have probably experienced somewhat higher tax collections than indicated above, as a result of voluntary participation in the SSUTA by some retailers that might otherwise not have decided to collect use tax.)

In light of these figures, I would hope that members of this Committee would question whether forsaking long-standing constitutional standards is the proper response to the greatly exaggerated, and largely self-correcting, problem of lost use tax revenue claimed by state tax officials.

Jurisdictional Limitations On State Taxing Authority Are Not A Legal "Loophole" Exploited By Retailers, But Rather Derive From Core Constitutional Principles.

The stated purpose of H.R. 3396 is to authorize Member States of the SSUTA to subject businesses not located within their borders— *i.e.*, companies lacking "nexus"—to tax collection and remittance obligations. This is no trivial matter. Determining the appropriate reach of the sovereign authority of state and local governments is central to the American system of government. Indeed, the Constitutional Convention of 1787 was initially called to address the problem of individual state legislatures imposing taxes and duties on trade with other states, a practice that was pushing the young country into a depression. The solution devised by the Constitution's Framers was a federal system of dual national and state sovereignty, the genius of which is that *each state is sovereign within its own borders* and can adopt those policies that best suit its particular needs and reflect the political preferences of its citizens. Needless to say, this plan has worked remarkably well for more than 200 years.

Of necessity, federalism restricts the ability of a state (or locality) to export its tax system across state borders. Permitting each state to visit its unique tax system on businesses that have no nexus with the taxing state would be chaotic as a matter of both tax administration and compliance (involving fifty state governments, and the more than 7,500 local taxing districts in the United States, imposing their vastly different tax regimes on businesses in each of the forty–nine other states). Moreover, out–of–state companies would have no way to influence the very state tax systems that are newly imposed on them. In the most real sense, allowing the expansion of tax authority beyond state borders is "taxation without representation."

The Constitutional limitations on the territorial scope of state and local taxing jurisdiction also has enormous economic importance. The United States Constitution – and the Commerce Clause in particular – has been the guardian of this nation's open market economy. A central purpose of the Commerce Clause was to prevent states from suppressing the free flow of interstate commerce by imposition of taxes, duties, tariffs, and other levies. Indeed, more than two centuries before the establishment of the European Union, the Framers of the United States Constitution created a common market on this continent through the Commerce Clause, and their foresight powered the greatest economic engine mankind has ever known.

In this era of electronic commerce and increased international competition, it is imperative that Congress not abandon, or undermine, the core Commerce Clause principle of a single, free-flowing national marketplace. In the last two decades, U.S. companies have been dominant in the field of electronic commerce; but abandoning constitutional ideals in favor of short-sighted efforts to increase state tax revenues could undermine the position of American companies in this crucial, but still fledgling, sector of the world's economy. The vitality of e-commerce should not be curbed by federal legislation that saddles American businesses with the

burdens of disparate state tax laws whose authority extends far beyond traditional jurisdictional borders.

With record high energy prices threatening the nation's economy, now is certainly not the time for Congress to abandon the original intent of the Commerce Clause. Moreover, debate over the wisdom of a federal law to expand state and federal tax jurisdiction cannot be divorced from consideration of the impact such legislation would have on the competitiveness of American companies. Forcing new tax collection obligations on U.S.-based companies would have the undesirable (and undoubtedly unintended) effect of advantaging their foreign competitors, on whom state and local tax collection obligations could never be effectively imposed.

Congress should be skeptical of arguments that the Commerce Clause is outdated and its restriction on state taxing authority is nothing more than a constitutional loophole exploited by business. As a professor of Constitutional Law, I respectfully disagree. In my view, the Supreme Court's consistent application of long-standing constitutional principles should not be viewed as a "problem" in need of correction. Rather, the inter-related ideals of federalism and unfettered interstate commerce have made America both the greatest experiment in representational democracy and the most successful economy the world has ever known.

H.R. 3396 Would Unfairly Burden Businesses In A Majority Of States To Satisfy The Demands Of A Minority States That Are Members Of The SSUTA.

The proposed legislation being considered by this Subcommittee would be unfair to the great majority of states—including California, Texas, New York, Florida, Illinois, Pennsylvania, and Massachusetts—which have elected not to become members of the SSUTA. The burdens of H. R. 3396 would fall primarily on businesses in those states that will realize no reciprocating

benefit. The legislation grants favored treatment to the minority of states that are Full Members of the SSUTA (only 17 states, representing approximately 25 percent of the nation's population). The bill would allow those few states to impose tax collection, reporting and remittance duties on *retailers in every other state in the nation*, regardless of whether a state is a member or not a member of the SSUTA.

Most states that participated in the Streamlined Sales Tax Project have decided not to become members of the Streamlined Sales and Use Tax Agreement for a variety of different reasons. The most common reason is that these states (primarily larger states) do not want to surrender their tax sovereignty to the dictates of the SSUTA Governing Board. Consequently, most states have concluded that membership in the SSUTA would be detrimental to their best interests.

H.R 3396 would, nonetheless, force non-participating states to tolerate the incongruous situation in which companies headquartered in their states are required to collect sales/use taxes for SSUTA member-states, but there would be no similar and reciprocal obligation on the part of retailers located in the SSUTA member-states. To put the issue in more specific terms, under this bill, an Internet retailer based solely in California or Massachusetts (neither of which are SSUTA members) would be subject tax collection, reporting and remittance obligations for its sales to residents of Nebraska, North Carolina, Wyoming, and every other SSUTA state, but neither California nor Massachusetts would receive any additional tax revenue from an Internet retailer with operations solely in any of the SSUTA member states. In this regard, H.R. 3396 is hardly a bill promoting sales tax fairness for retailers, consumers, and states through the country.

Supporters of H.R 3396 argue that the legislation would encourage additional states to bring their sales/use tax laws into compliance with the SSUTA. But this is faulty and self-

flattering reasoning. If the SSUTA were attractive on its own merits, more states would have already joined. Instead, the reality is that the legislatures in the vast majority of states, making up more than 70 percent of the United States population and including each of the six largest states in the nation – California, Texas, New York, Florida, Illinois, Pennsylvania – have chosen not to adopt the SSUTA for good reasons. Legislative leaders in those states have concluded that the SSUTA is simply not consistent with their state's tax scheme (*e.g.*, sourcing requirements) or otherwise is not in the state's best interest. Large states are also skeptical of handing over authority to an SSUTA Governing Board dominated by tax administrators from smaller states. Moreover, because the SSUTA has been so frequently amended by the Governing Board despite the short life of the Agreement, these larger states are concerned over what future requirements might be imposed upon them by the Governing Board in the event they were to become Full Members.

In fact, it is this inherent tension between the insistence of states on maintaining sovereignty, pitted against the desire to expand their taxing jurisdiction, that has made the SSUTA fatally flawed and doomed to fail in achieving real simplification and uniformity in state and local sales and use tax systems.

The SSUTA Adopted "Low Bar" Reform From The Outset And Has Proven To Be A Moving Target Of Increasing Complexity And Decreasing Uniformity.

Although nominally a bold reform initiative to simplify, harmonize and modernize state and local sales and use tax laws, the Streamlined Sales Tax Project has never promoted true simplification or uniformity. Instead, state tax administrators, from the outset of the Project, and at every turn since, have sacrificed real reform to accommodate the peculiarities of individual states tax systems. The goal of the Project's organizers was not to maximize uniformity among

state laws, but rather to maximize the number of states willing to sign-on to SSUTA full membership .

The inevitable result of this recruitment-at-all-costs strategy has been the progressive dilution of the Project's stated uniformity objectives. Successive compromises of the SSUTA's stated principles have produced a lowest-common-denominator standard for sales/use tax reform. Moreover, these on-going revisions have made the SSUTA a moving target for affected businesses, as they confront frequent amendments, illogical interpretive rulings and a burgeoning number of complex rules. Having closely followed and contributed to the SSTP process over the past 7 years, I find the contrast between the SSUTA process and the more conventional drafting process for uniform state legislation developed by the Commission on Uniform States Laws (such as UDITPA) a most striking one.

The SSUTA Failed To Adopt Fundamental Requirements Of Simplicity And Uniformity.

To understand the dissolution of the SSUTA process, it is instructive to consider its history. The Streamlined Sales Tax Project was launched in 2000 on the heels of two earlier joint government/industry initiatives (the National Tax Association (NTA) Communications and Electronic Commerce Tax Project, and the congressionally–established Advisory Commission on Electronic Commerce), both of which had concluded that the existing state sales and use tax system was one of daunting complexity, and that true simplification would require sweeping reforms. To this end, in August 2000, the Direct Marketing Association set forth in a letter to Steamlined Sales Tax Project leaders a comprehensive list of reform proposals, a copy of which is attached to my written testimony. The fate of DMA's proposals is telling: of more than 30 specific reform recommendations offered by the DMA, the SSUTA fully adopts only two,

centralized registration and uniform bad debt provisions, and the latter provision has not been honored by most of the member states.

Perhaps most emblematic of the SSUTA's failure to achieve genuine sales/use tax reform was the early demise of the single most important step toward simplification: the adoption of a single sales and use tax rate per state for all commerce ("one rate per state"), which would have eliminated the problem of merchant compliance with thousands of local tax jurisdictions with different tax rates. The United States is the only economically developed country in the world with a system of sub-state transaction taxes not only for municipalities and counties, but also for school districts, transportation districts, sanitation districts, sports arena districts, and other local tax jurisdictions. In light of this wildly complex system, the adoption of a "one rate per state" standard was the unanimous recommendation of the NTA's E-Commerce Project (which included delegates from the National Conference of State Legislatures, National Governors Association, and the U.S Conference of Mayors) and was also the majority report recommendation of the Congressional Advisory Commission.

Despite this background, the SSTP abandoned the "one rate per state" standard early in its deliberations, and instead decided to permit (a) two state-level rates (one of which only applies to food, food ingredients, and drugs) and (b) additional separate rates as chosen by each local taxing jurisdiction in the state. The effect of this decision was to allow an increase, rather than require a decrease, in the number of sales/use tax rates to which an interstate merchant might be subject in collecting and remitting taxes.

How could such a fundamental goal of sales/use tax reform be forsaken so early in the SSTP process? State tax administrators associated with the SSUTA now freely admit that the "one rate per state" proposal was dead on arrival, because they quickly were informed that it was

unacceptable to most states and localities who clearly prized their unique taxing prerogatives over the uniformity and simplification recommendations of the prior commissions.

I have had the opportunity, in testimony before this Subcommittee (in October 2003) and last year (July 2006) before the Senate Finance Committee, to explain in detail numerous other ways that the SSUTA disregarded broadly recognized principles of sales/use tax simplification and standardization, and I would be happy to provide copies of such testimony to the Subcommittee members. In brief, a few of these glaring shortcomings include:

- **The failure to establish uniformity in the tax base:** The SSUTA rejected from the outset adopting a uniform tax base, instead insisting that uniform definitions among states for taxable and exempt products would be adequate simplification for retailers. But the number of product definitions in the SSUTA to which member states must adhere is very limited, and states can choose to exempt or tax any product or service not specifically defined. The Agreement has no definitions that would cover many every day consumer items, from cookware to holiday decorations to home and garden items.

- **There is no uniformity in the measure of tax for like transactions**: The SSUTA also does not simplify the way retailers must measure the dollar amount (transaction value) subject to tax. Instead, the SSUTA's definition of "sales price" allows states to include, or exclude, multiple components, resulting in a dizzying array of state-specific alternatives, with no uniform measure of tax among states for identical transactions. In fact, as explained later, the SSUTA has recently made the determination of "sales price" even more complex.

- **There is no meaningful reduction in the burdens of tax collection, reporting, remittance and audits for interstate marketers**: State tax administrators refused to adopt a proposal for joint audits (i.e., one audit for all member states). As a result, the number of tax audits to which an interstate marketer would be subject under H.R. 3396 would substantially increase over current practice, since non-nexus companies would become subject to audit not only by the state revenue department in their home state, but by tax auditors from each of the member states, at considerable additional administrative burden and expense to America's retailers.

- **The SSUTA failed to seek independent testing of tax compliance software tax compliance software**: While SSUTA officials rely heavily on computer technology as the "silver bullet" to address the increased tax compliance burdens that would result from passage of H.R. 3396, the Project never sought independent testing of the software systems put forward by service providers (none of which were originally developed for the purpose of SSUTA compliance), and instead conducted the certification process internally. To date, the SSUTA has certified 3 private companies, but many retailers,

after investigating the available providers, have concluded that using their software would be prohibitively expensive without any real guarantee of accuracy. Moreover, despite the fact that private service providers will have access to highly confidential personal consumer information, the SSUTA has no articulated standards for assuring the security and privacy of such information.

- **The failure to guarantee fundamental fairness with respect to vendor compensation for tax collection**: On its face, the SSUTA, since its adoption in 2002, has required states to compensate both third party service providers and self-reporting vendors for the considerable costs of serving as the states' collection agents, but five years later the Governing Board has only approved compensation for the certified providers (who would not, of course, have sought certification otherwise), and has reneged on its promise of compensation to retailers.

The SSUTA Has Been Steadily Weakened Since Its Adoption Through A Myriad of Amendments And Interpretive Rulings That Lessen Its Uniformity Requirements And Increase Its Complexity.

Regrettably, the SSUTA has suffered a further "lowering of the bar" since its initial adoption. Again, in stark contrast to a truly Uniform Act, such as the Uniform Division of Income for Tax Purposes Act, which was promulgated 50 years ago and has remained remarkably stable over time, the SSUTA has already been subject to more than 70 amendments during its short life span. Not surprisingly, there are nearly 20 additional proposed amendments on the agenda for the Governing Board's meeting next week. Dozens of the Agreement's provisions have been materially modified; whole sections have been repealed or replaced; and new sections have been added. At the same time, the Governing Board has issued numerous interpretive rulings which, rather than requiring member states to conform strictly to the Agreement's provisions, have instead tolerated widely disparate practices by member state revenue departments. The result has been to increase, rather than reduce, variations in the administration of state tax laws. In a very real sense, the SSUTA is a moving target, adding new uncertainties for businesses and increasing both their compliance costs and their exposure to unanticipated tax assessments.

The SSUTA Has Openly Authorized States To Adopt Replacement Taxes.

Many of the recent amendments to the SSUTA, as well as those currently under consideration by the Governing Board, represent a further degradation of even the modest uniformity provisions contained in the Agreement when it was first adopted. The enactment by member states of "replacement taxes," and the now infamous example of the "fur clothing tax," has become emblematic of the Governing Board's refusal to stand firm and of member states' refusal to abide by the Agreement's requirements. Instead, the Governing Board has tolerated, at times even encouraged, blatant departures from the substance and spirit of the SSUTA on the part of state governments in order to avoid member states from withdrawing, or being disqualified, from membership in the SSUTA.

The replacement tax issue came to the fore in the following way. SSUTA advocates proudly point to the list of product definitions as the Project's central accomplishment in achieving greater uniformity. Member states are required to adopt the definitions, and must then either tax, or exempt, all items that fall within each product definition. Among the defined products is "clothing," defined as "all human wearing apparel suitable for general use," with a lengthy, non-exclusive list of examples within the definition that includes furs. Observers, I among them, noted that the Full Member state of Minnesota exempted "clothing" from sales and use tax, but separately imposed an excise tax on fur clothing, in apparent violation of the Agreement.

In 2006, I submitted a request to the SSUTA Governing Board for a determination whether the fur clothing tax imposed by Minnesota violated the Agreement. In response, the SSUTA's Compliance and Review Committee determined, and the Governing Board agreed, that because the fur clothing tax was denominated in Minnesota's statute as a gross revenues excise

tax separate from its general sales and use tax, it was not subject to the Agreement's requirements. In other words, simply re-naming a sales tax as an excise tax frees a state from the requirements of the SSUTA. The ruling clearly signaled to all states (current SSUTA members and those states that had reservations about surrendering tax sovereignty to the SSUTA) that they were free to game-the-system simply by re-naming transaction taxes to take them outside the scope of the Agreement.

This message was readily received by other states. For example, the legislature in New Jersey, another "Full" SSUTA Member, soon followed suit, enacting in its 2006 legislative session its own version of the fur tax. The New Jersey law creates a new gross receipts tax on fur clothing, despite the fact that New Jersey otherwise exempts "clothing" (as defined in the SSUTA) from its sales tax. Moreover, the New Jersey fur tax applies at a rate of 6 percent, despite the fact that New Jersey in 2006 raised its general sales and use tax rate to 7 percent. As a result, the New Jersey fur tax flaunts not only the definitional requirements of the SSUTA, but also the requirements that members have only one state–level sales tax rate (other than for food and drugs).

Following the enactment of the New Jersey tax, there was an outcry among observers, and even some supporters, of the SSUTA. Such "replacement taxes," *i.e.*, sales and use taxes re-named to avoid the Agreement, undermined the integrity of the entire SSUTA process. The SSUTA's Business Advisory Committee, comprised of industry supporters of the Agreement, was highly critical of the enactment of replacement taxes. Proposals were presented to the Governing Board to prohibit the practice. To date, however, these proposals have not been acted upon, and the SSUTA Governing Board has failed to pass an amendment, or even a resolution,

that would prohibit state legislatures from making an end-run around the SSUTA by adopting replacement taxes.

Rather than punish states that have enacted replacement taxes, the Governing Board has instead chosen the path of least resistance. Its approach has been: "If a state violates the Agreement, we will simply change the Agreement." With the fur clothing tax, rather than disciplining New Jersey, the SSUTA in December 2006 amended the Agreement to remove fur from the general "clothing" definition and approved a new, separate definition of "fur clothing," thus allowing separate tax treatment for fur clothing and glossing over the non-conformity of both New Jersey and Minnesota.

The SSUTA Has Eliminated Uniformity In The Treatment of Delivery Charges.

The SSUTA Governing Board's willingness to bend and amend the Agreement to accommodate state-specific tax practices has taken a decidedly disturbing turn in connection with the treatment of delivery charges. Consumers need to know whether sales tax will be computed before or after inclusion of "shipping and handling charges." Early in the streamlining project, the Direct Marketing Association urged uniformity on this subject for the benefit of consumers and retailers alike. Not only did the SSUTA not incorporate DMA's original proposal, but recently it has taken a giant step backward from the position taken at the time of the Agreement's original adoption.

A little background on this subject may be useful in understanding direct marketers' concerns. The tax treatment of charges to consumers for delivery of products has long been an area of considerable complexity. Some states impose tax on all delivery charges; others exempt all delivery charges so long as they are separately stated on the invoice; some states tax handling charges, but not common carrier freight charges; most, but not all, states exempt postage charges

for direct mail paid to the USPS, even if the state taxes freight charges by a private carrier; some exempt "shipping" charges only if they represent the actual cost of shipping a particular product, but not if the charge is based on average shipping costs; and the list goes on.

Initially, the SSUTA sought to simplify the definition of "delivery charges" to include all charges related to delivery of product to a purchaser, which meant not only shipping costs, but also handling and other charges (including postage, a decision which allowed some member states to impose new taxes on postage they had not previously levied). At the same time, however, the SSUTA protected state tax prerogatives (at the expense of uniformity) by listing delivery charges among those items that a state could elect to include, or exclude, from the taxable "sales price" of the product.

Under political pressure from a number of quarters, including states that previously separated the tax treatment of shipping from other charges, the Governing Board in September 2007 approved an amendment that modifies the definition of "delivery charges" under the Agreement to allow member states to treat "shipping" separately from "handling," undoing any simplification that had previously been achieved. Beginning in 2008, SSUTA member states may elect to tax both shipping and handling, may tax neither, may tax only shipping and not handling, or vice-versa. As a result, the number of possible permutations of the taxable "sales price" that consumers and retailers may encounter has greatly increased.

The SSUTA Has Interpreted Some Definitions, In Particular "Direct Mail," To Apply Only For Administrative Purposes, Leaving States Free To Tax or Exempt Multiple Additional Products.

In addition to amendments to the Agreement, the official Interpretations issued by the SSUTA Governing Board and its committees have further degraded any claim to uniformity. For example, the SSUTA contains a definition for "direct mail," *i.e.*, printed material delivered at

no charge via U.S. Mail or by another delivery service to a mass audience or persons identified on a mailing list. This is an area of great importance to the direct marketing industry. In October 2006, the SSUTA received a seemingly innocuous request "[w]hether billing invoices, return envelopes and any additional marketing materials are included in the definition" of direct mail. Although on its face this was a question about the definition, the answer had additional significance because Member States are authorized to allow a different tax treatment for "delivery charges" on direct mail transactions, *i.e.*, to include or exclude such charges on direct mail in a manner different from the state's treatment of delivery charges for most products.

The SSUTA's Interpretations Committee found that the invoices, envelopes and other items met the SSUTA's definition of direct mail, but then went on to state that the definition of "direct mail" in the Agreement applies only for the purpose of determining proper "sourcing" of sales transactions, and *not* for determining whether "delivery charges" are included in the taxable price! The Governing Board subsequently approved the ruling in December 2006.

The direct marketing industry was left totally confused. As a strained rationale, the SSUTA stated that the "direct mail" definition appears in the Agreement's "Administrative Definitions" and not its "Product Definitions," so that the Agreement does not purport to define, at all, what categories of printed material are subject to tax in a Member State, and what categories are not subject to tax. In other words, states could have conflicting definitions and categorization of direct mail for different tax purposes. Indeed, several SSUTA Member States have chosen to tax and exempt different categories of printed materials, all of which appear to meet the uniform definition of "direct mail" under the Agreement. The result is that even though the SSUTA purports to define "direct mail," sellers and buyers cannot look to the Agreement to

determine whether their products and services are subject to tax or not, or what taxable measure applies to the transaction.

The Interpretive Ruling that the SSUTA's "Administrative Definitions" cannot be relied upon to determine which types of "direct mail" are taxable and which are not, is disturbing, yet there are now proposed amendments pending before the Governing Board that would formalize and extend that understanding to all Administrative Definitions in the Agreement. Currently, the "Administrative Definitions" include such terms as "bundled transaction," "delivery charges," "telecommunications non-recurring charges," none of which apparently can be relied upon anymore by retailers for guidance except in regard to the "administration" of taxes under the Agreement. Perhaps most incredibly, the Administrative Definitions include the SSUTA's definition of "tangible personal property," the bedrock definition of every sales and use tax system. On even this point, the SSUTA has implicitly disavowed uniformity among the Member States.

Sales Tax Holidays Defeat Uniformity, And The SSUTA Fails To Resolve This Problem.

One of the myriad ways the SSUTA has bowed to parochial state concerns is through its preservation of sales tax "holidays," the temporary suspension of sales and use taxes on particular products or classes of products, such as clothing, computers or school supplies. Sales tax holidays are increasingly attractive to state legislatures as (a) a form of consumer tax relief, (b) a way to encourage purchases that will promote certain state government policy objectives, and (c) a means of stimulating the economy around specific seasonal events, such as the start of the school year. Although this form of short-term tax incentive is very popular with the public, and always focused around local events, sales tax holidays present enormous complexity to interstate retailers, who need to publish tax instructions on their websites and in their catalogs.

The SSUTA currently permits members to implement such tax holidays only with respect to product categories specifically delineated in the Agreement (such as clothing or school supplies). The Agreement, however, imposes no limit on the duration of such holidays, and allows states to impose eligibility thresholds, so that the temporary exemption applies to purchases only above a minimum dollar amount, increasing the complexity for retailers to administer tax holidays.

The popularity of sales tax holidays among state legislatures means that new proposals for such holidays are frequent. Now before the Governing Board is an amendment proposed by North Carolina, a Full Member state, to allow a sales tax holiday for all products that qualify for "Energy Star" designation under guidelines set by the U.S. Department of Environmental Protection. According to the EPA, products in *more than 50 categories* qualify for the Energy Star label. Authorizing a sales tax holiday based on such a designation would have the effect of creating a new mini-tax system of limited duration. Moreover, every SSUTA Member State would be free to choose whether, when and for how long to implement such a holiday, imposing enormous burdens on retailers. It is precisely the pursuit of such state-specific tax policy objectives that generate the overwhelming complexity in sales and use tax systems.

Even more complex proposals for sales tax holidays are being considered by state legislatures. This year, the State of Florida (not currently a Member of the SSUTA) adopted a "Hurricane Preparedness Sales Tax Holiday" running for 10 days in late May, 2007 designed to encourage residents to prepare for the hurricane season. The holiday applied to dozens of types of products in multiple categories, such as candles and flashlights, coolers and ice chests, cell phone batteries, radios, tarpaulins, and window shutter materials. Moreover, the exemptions for different types of products applied only *below* a specified dollar cap, such as $20 for gas-powered lanterns, $50 for bungee cords, and $75 for carbon monoxide detectors. This may be

laudable tax policy, but allowing such a system to be exported across state lines would require retailers across the country to comply with the unique policy prerogatives of distant states. Such a system would place crushing burdens on interstate commerce.

The SSUTA Is Poised To Compromise Its Adoption Of Uniform, Destination-Based Sourcing.

The one rate per state proposal has recently re-surfaced in the debate among SSUTA members concerning the "sourcing" of transactions for sales and use tax purposes. "Sourcing" is the term used by tax analysts to describe the mechanism for determining which jurisdiction will have the opportunity to tax a particular transaction. The issue of sourcing would be far less controversial under a "one rate per state" rule, because the absence in variation among tax rates within a state would make sales tax compliance straightforward. However, when local rates differ widely, the issue of which jurisdiction gets to tax the transaction becomes very confusing. Does a merchant who delivers product from one jurisdiction to another charge sales tax at the merchant's home district rate ("origin sourcing") or must the retailer "source" the sale to the location where the product is received and collect tax based on the recipient's jurisdiction ("destination sourcing")?

The SSUTA originally committed itself, for reasons of simplicity and uniformity, to destination sourcing for all transactions. This meant that a retailer would collect tax for the state and local jurisdiction where the consumer – not the retailer – is located. This effort at uniformity has not gone down well, however, with a number of states and localities that permit or require origin sourcing for in-state vendors. Consequently, the SSUTA Governing Board has been asked to abandon its commitment to destination sourcing and accommodate states that want to have destination sourcing at the state level but origin sourcing at the local level. Such a change in the

SSUTA would hardly serve the interests of consistency, simplicity, and uniformity. But those concerns have not deterred the Governing Board from amending the Agreement in the past.

If a state allows origin sourcing for in-state businesses, while demanding destination sourcing for out-of-state businesses (as some of the proposed amendments would permit), there is an obvious issue of fairness. Moreover, if the combined state and local tax rate applicable to an in-state seller is lower than the combined rate applicable to an out-of-state seller for a comparable transaction, the Supreme Court has ruled that such a tax scheme violates the Commerce Clause and is unconstitutional. *Associated Industries of Missouri, Inc. v. Lohman,* 511 U.S. 641 (1993).

An obvious question is: "Why would the Governing Board consider abandoning its straightforward commitment to destination sourcing for all transactions and, instead, create a complex set of rules that would differentiate between state and local taxes on the one hand, and in-state and out-of-state sellers on the other hand?" The answer is that the Governing Board is willing to abandon principle to attract new Member States.

Instead of insisting on state conformity with the original requirements of the SSUTA as a condition of Full Membership, the Governing Board is trying to broker a "compromise" that would permit states to retain their origin sourcing rules. Interestingly, Indiana, one of the states represented on the Governing Board, has proposed an amendment that would, in effect, allow a member state to adopt a separate single rate for delivery sales (in contrast to over-the-counter sales). This would have the effect of keeping compliance burdens on in-state sellers light, but it would also eliminate much of the unfairness of disparate sourcing rules for out-of-state sellers. Thus, under the Indiana proposal, states with origin sourcing could join the SSUTA without adopting destination sourcing, if they would adopt one rate per state. Although the Indiana

proposal is on the agenda for the meeting of the SSUTA Governing Board next week, and has considerable support among the business community, Governing Board officials have indicated in public meetings that they feel the proposal does not even merit discussion, because states with origin sourcing will never accept the "one rate per state" alternative, showing again that real reform under the auspices of the SSUTA is impossible.

The DMA has expressed its concerns regarding multiple sourcing provisions for a single state in a letter to the Governing Board. I attach a copy of my letter dated September 12, 2007.

The SSUTA Has Repeatedly Compromised Conformity Standards In Order To Increase Or Maintain Membership.

The SSUTA has repeatedly demonstrated a willingness to descend to the lowest-common-denominator of uniformity in order to accommodate members and potential members, and it has likewise repeatedly bent and even changed its rules regarding compliance requirements. The purpose behind this progressive lowering of the bar has been to enlist and retain member states that are unable or unwilling to bring their laws in line with the Agreement's requirements.

A Weak Compliance Standard. To become and remain a member of the SSUTA, a state must only certify to the Governing Board that the "effect" of its laws, rules, regulations and policies is "substantially compliant" with each of the requirements of the Agreement. This weak standard of compliance means that there is no guarantee that any Member State's laws are fully compliant with the terms of the Agreement to begin with. This is only one way that the SSUTA has enabled states to circumvent its compliance requirements.

The SSUTA Began By Creating a Class of Not Fully Compliant "Associate Members." Initially, the Agreement, by its terms, was only to take effect when at least ten states comprising at least twenty percent of the total population of all states imposing a state

sales tax were determined to be in conformity. The participating states set a deadline for themselves of October 1, 2005 to achieve this level of conformity.

The SSUTA Governing Board was so concerned, however, in April 2005 that it would not secure the membership of enough states to meet their self-imposed threshold, that it quickly adopted a new provision allowing for so–called "Associate" Members, which were states that the Project participants acknowledged had not yet conformed their laws to the Agreement, but which states would, nonetheless, be counted toward the critical mass necessary for the SSUTA to become effective. State representatives to the SSUTA have publicly acknowledged that the provisions regarding Associate Members were adopted in haste in 2005, without careful consideration of all of the ramifications of creating this second class of members on other parts of the Agreement, in order to "meet the quota" necessary for the SSUTA to take effect.

When this new category of membership was created in April 2005, Associate Members were given more than three-and-a-half years, until December 31, 2007, to bring their laws into full conformity with the Agreement, or they would forfeit their Associate Membership status. At the time the participating states declared success in meeting the membership threshold on October 1, 2005, there were six states granted Associate Membership status: Arkansas, Nevada, Ohio, Tennessee, Utah, and Wyoming. Together with the thirteen states granted Full Membership, the SSUTA claimed to have enlisted states comprising a little more than 29 percent of the population as of October 1, 2005.

The SSUTA Next Refused to Expel Utah After Its Legislature Repealed Conformity Legislation. After creating the Associate Member category, SSUTA officials have shown themselves ready to take any measures necessary to prolong the membership of Associate Members. The first such compromise came in 2006, when the legislature in Utah, one of the

Associate Member states, repealed a large number of laws that had originally been enacted to bring the state into SSUTA conformity. There was no question that Utah's tax code was no longer in compliance with multiple SSUTA requirements and that the state did not, after the repeal legislation, meet the standard for Associate Membership.

Rather than take steps to terminate Utah's SSUTA membership, the Governing Board determined that it was not required to expel Utah on the theory that, under the Agreement, the status of Associate Members did not need to be reviewed until the December 31, 2007 deadline for full conformity. The Governing Board simply declined to take up the matter of Utah's non-compliance and, as of this date, Utah remains an Associate Member, accepting SSUTA vendor registrations, participating on SSUTA committees, and voting on matters with other Associate Member states.

The SSUTA Created A New Category of Associate Member to Accommodate Tennessee. While some states originally granted Associate Member status have subsequently petitioned for and been granted Full Membership, the two largest of the states initially granted Associate member status in 2005, Ohio and Tennessee, have remained Associate Members. In Tennessee, a number of the changes in its laws that have proven most controversial within the state were adopted with effective dates pushed off well into the future for political reasons. The proposed effective date for many such laws had been July 1, 2007, in time for the December 31, 2007 deadline for Associate Member States to come into full compliance. But in the 2007 legislative session, the Tennessee legislature pushed back the effective date on many provisions until July 1, 2009, delaying the date for the state's possible conformity until after the SSUTA's previously set deadline.

Rather than Tennessee losing its membership status, the SSUTA in June 2007 promptly enacted an amendment to the Agreement which created a new category of Associate Members, described as states petitioning for membership after January 1, 2007. Such states are qualified for Associate Membership status if they are found to be in compliance with the Agreement's requirements except that the effective date of their conformity is delayed for not more than twelve months, or with Governing Board approval, eighteen months, beyond their proposed entry date into the Agreement.

Although Tennessee was already an Associate Member prior to January 1, 2007, it was nevertheless permitted to petition for Associate Member status under the new provision for Associate Members petitioning after January 1, 2007. The Governing Board promptly approved Tennessee's Associate Member status under the new provision, based on its proposed new conformity date of July 1, 2009. These machinations are little more than smoke and mirrors.

The SSUTA is Poised to Make Concessions on Origin Sourcing to Extend The Deadline For Ohio. Of considerable concern now to SSUTA officials is the impending failure of Ohio, the largest state with membership status in the SSUTA, to gain full membership status by December 31. For Ohio, the central issue of non-conformity is its system of in-state origin sourcing. With Ohio's deadline to conform to the SSUTA approaching, the Ohio legislature in the 2007 legislative session not only declined to adopt destination sourcing, but affirmed its system of origin sourcing. As a result, Ohio will not meet the December 31, 2007 deadline for conformity, and will be required under the current language of the Agreement to forfeit its membership.

SSUTA officials desperately want Ohio to retain its membership and, indeed, to attain Full Member status. Indeed, the possibility of Ohio falling out of the SSUTA, together with the

desire to attract other states that have origin-based sourcing, is driving the Governing Board's push to amend the agreement and depart altogether from a uniform destination-based sourcing standard.

At the same time, separate amendments have been proposed regarding Associate Member status that would prolong Ohio's membership. One such measure would simply extend the current conformity deadline by an additional six months, to July 1, 2008. Another would allow the Governing Board to approve Associate Membership for a state whose only area of non-conformity is with SSUTA sourcing rules. The proposed amendments will be voted upon at next week's Governing Board meeting. Given the SSUTA's track record to date, it will come as no surprise if Ohio is granted some form of reprieve and remains an Associate Member for some additional period of time. When it comes to membership status, SSUTA rules are meant to be waived not enforced.

The Governing Board Amended the Agreement to Approve New Jersey's Non-Conforming Fur Tax. The SSUTA's weak stance on conformity has also benefited at least one Full Member State. As I explained earlier, the New Jersey legislature in 2006 enacted a replacement "fur tax" which most observers believed was not in conformity with the Agreement's requirement that a state tax or exempt all products for which the Agreement has a formal definition. After New Jersey enacted the fur tax, the SSUTA, rather than disciplining or even expelling the state in its annual re-certification process, simply amended the Agreement to adopt a definition for fur clothing, thus bringing New Jersey's fur tax into *post-hoc* conformity.

Despite Repeatedly Diluting Its Standards, The SSUTA Has Not Attracted Many New Members, And Now Faces Declining Membership

The contortions the Governing Board has gone through to retain members is probably best explained by its inability to attract additional participation by states. The SSUTA has

proven unattractive to most states, and the largest states have been most averse to membership. A number of state legislatures, including Florida and Virginia, have outright rejected conformity legislation. Upon the Agreement's effective date in October 2005, the SSUTA had 13 Full Member states; on January 1, 2008, it will have 17. The only states to join as Full Members in the past three years have been Arkansas, Rhode Island, Vermont and Wyoming. The SUSTA is clearly a minority system.

In fact, the SSUTA is losing membership. With Ohio and Utah due to fall out of the SSUTA, the percentage of population will likely fall below the 29 percent level claimed by the SSUTA in October 2005. In fact, if the SSUTA were vigilant regarding compliance and excluded both Tennessee and New Jersey, the percentage of the population represented by Full and Associate Member States participation would fall dangerously close to the 20 percent threshold necessary for the Agreement to remain in effect under its own terms.

It is now time for the Streamlined Sales Tax Project to confront the painful reality that the terms of the SSUTA and its governance procedures are fundamentally flawed, that it has not achieved meaningful sales and use reform, and that is not attractive to the great majority of states. It is time, instead, to re-assess the process that brought the SSUTA to this point and initiate a new process, perhaps through the Commissioners on Uniform State Laws, to craft a truly uniform act whose hallmark is real simplification of state sales and use tax regimes. On behalf of the DMA, I want to thank you again for the opportunity to offer my comments on this important issue.

SETTING THE RECORD STRAIGHT:

THE MODEST EFFECT OF ECOMMERCE ON STATE AND LOCAL SALES TAX COLLECTIONS

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Summary

A frequently cited academic study underestimates the amount of state and local tax currently collected on ecommerce sales by as much as a factor of ten. Published in 2000 and revised in 2001 by University of Tennessee researchers, both versions of the study are based on stale data and, at least in hindsight, flawed assumptions. Yet both versions still are referenced in news articles and elsewhere.

Among other shortcomings, the Tennessee study (1) overestimates total ecommerce sales; (2) underestimates B2B tax compliance; and (3) inadequately accounts for sales by multi-channel B2C sellers. The present paper corrects these errors and provides a far more realistic, updated assessment of tax collections on ecommerce sales. For example, in 2006, the total uncollected tax on ecommerce was only $4.2B nationwide or about 0.2% of estimated total state and local tax revenue of $2.12 trillion for 2006.[1] This is less than a tenth of what Tennessee estimated in 2000 and less than a quarter of their 2001 revised estimate.

Beyond these errors, the Tennessee study ignores the effects of three additional factors that could dramatically reduce the sales tax revenues available to state and local governments. The first factor is whether Congress or the Supreme Court ever would allow states participating in the Streamlined Sales Tax Project ("SSTP") to require tax collection by businesses in states not participating. Because, at present, states with over four fifths of the US GDP are *not* fully participating, only about $145MM, or a tiny fraction of total state and local tax revenue would become available in a mandatory collection regime among participating states.

The two other factors ignored in the Tennessee study involve policy proposals to exempt some vendors from collection requirements and to provide collection compensation to other vendors. Because the SSTP has failed to quantify the potentially large effects of these proposals, no attempt is made to quantify them here. But if any seller exception or vendor compensation is provided, there *must* be a reduction of revenue available to the states and localities; the only question is by how much the Tennessee study errs by not considering these factors.

In sum, when properly measured with updated data, the effect of uncollected sales taxes is far more modest than the gaping losses forecast by Tennessee early this decade, and any hopes that increased ecommerce tax collections will significantly fortify state and local government treasuries are illusory, at best.

I. TOTAL ECOMMERCE SALES

Contrary to predictions made in the Tennessee study and elsewhere earlier this decade, ecommerce sales remain a small part of the US economy. As shown in Table 1, in

[1] Projection for 2006 based on actual $2.02 trillion for 2005 as reported by U.S. Census Bureau, Annual Survey of State and Local Government Finances (01-Jun-07).

2005 total ecommerce (excluding services) represented less than 10% of total US commerce. The low portion of US economic activity attributable to ecommerce in the middle of the decade is reflected in a compound annual growth rate ("CAGR") for all ecommerce (B2B and B2C) much lower than that envisioned by Forrester Research and others for this period; it actually was only 17.2% for 2002-05, while the CAGR for B2C alone over the same period was 27.4%.

Table 1: Actual and Projected E-commerce Growth, 2005 – 08 ($billions)

	Actual	Projected		
	2005	2006	2007	2008
Total US Commerce	**$ 19,589.0**	**$21,061.0**	**$22,531.5**	**$ 24,002.0**
All Ecommerce (Net of Services)	**$ 1,834.0**	**$ 2,149.5**	**$ 2,518.7**	**$ 2,952.7**
Ecommerce as % of total:	**9.4%**	**10.2%**	**11.2%**	**12.3%**
Of Which:				
B2B Ecommerce	**$ 1,741.0**	**$ 2,035.5**	**$ 2,381.8**	**$ 2,789.1**
B2C Ecommerce	**$ 93.0**	**$ 114.0**	**$ 136.9**	**$ 163.6**

Source: US Dept of Commerce Census Bureau E-Commerce Report 2007; authors' projections based on historical data Bruce, Donald and William F. Fox (2001): "State and Local Sales Tax Revenue Losses from E-Commerce: Updated Estimates." Center for Business and Economic Research, University of Tennessee.

The Tennessee study, however, accepted Forrester's far higher growth rates (42.1% and 38.1% for total and solely B2C ecommerce, respectively, for 2002 -2005) and has not corrected them fully since that time. Thus it significantly overestimated sales and predicted much higher than actual available tax revenues. Moreover, the growth rate of ecommerce continues to slow faster than the Tennessee study forecast.

Table 2: Comparison of Projected Ecommerce Growth Rates

2002 - 05 CAGR	U of T	Actual
All Ecommerce	42.1%	17.8%
B2B Ecommerce	42.4%	16.7%
B2C Ecommerce	38.1%	27.4%

Source: Bruce and Fox, 2001; US Dept of Commerce Census Bureau E-Commerce Report 2007; authors' projections based on historical data

II. B2B TAX EXEMPTION AND COMPLIANCE

The Tennessee study significantly underestimated both the B2B share of total ecommerce and the tax compliance rate for B2B sales in total ecommerce and, as a result, systematically underestimated the amount of sales/use taxes already collected.

There are two basic types of B2B ecommerce. One type is that conducted via closed Electronic Data Interchange (EDI) networks of mainframe computers. EDI accounts for a whopping 88% of all ecommerce transactions. These closed networks are used for

transactions in the manufacturing process. The majority of goods involved are not subject to sales or use tax; for those that are, the proprietary nature of these systems means remote sellers who participate automatically incur nexus, making the tax compliance rate on EDI sales effectively 100%.

The other type of B2B ecommerce is that conducted via the Internet. The US Government's 2000 GAO report on ecommerce surveyed the literature on estimated use tax compliance on B2B sales, noting that credible estimates ranged as high as nearly 100%, to figures somewhat higher than half that rate. The 65% used by the Tennessee researchers thus falls clearly towards the lower range of all percentages cited. The most thorough study was conducted by State of Washington's treasury department, and found that businesses remitted use tax at a rate in the middle of this range -- about 85%.

The reasons for high B2B tax collection compliance are straightforward. Businesses are much more likely than consumers to be audited, either by their own external auditors or by the government, and they usually enjoy significant economies of scale in record-keeping and tax-filing. Many also maintain complete accounting departments or employ professional bookkeepers.

Table 3 provides an updated and more accurate assessment of the size and composition of B2B sales within total ecommerce, and their impact on un-remitted use taxes. After carrying forward the total amount of B2B ecommerce sales in line 1, which is categorized somewhat differently from Department of Commerce data, treating services as B2B and excluding the "double-counting" of interplant transfers. This base was then used to ascertain the amount exempt arising from original manufacturing or services in line 2 (recognizing that use and sales taxes are levied exclusively on end consumption) Line 3 reports the residual, taking the value of B 2B wholesale sales (again, net of inter-plant transfers without transfer of title.) We then exclude EDI sales, where, as mentioned above, title is not taken or end consumption sales incur nexus when remote sellers use the purchaser's proprietary network. This exclusion together with auto sales (as requiring proof use tax compliance for registration purposes) yields the amount of B2B Internet commerce (line 6) which is adjusted to exclude sales in states where there is no sales tax (line 7).

Finally, in lines 8 and 10, we accept the University of Tennessee's 6.4% average state and local sales tax rate, and use the State of Washington's estimate of 85% compliance, as the most credible estimate currently available in the literature.[2] These yield the total tax liability and ascertain the portion which is remitted by purchasers, leaving the actual value which could accrue to states in line 12.

Table 3: Calculation of Unremitted Tax from B2B Ecommerce

		Actual	Projected

[2] General Accounting Office (2000), *Sales Taxes -- Electronic Commerce Growth Presents Challenges: Revenue Losses Are Uncertain.*

		2005	2006	2007	2008
1	Total B2B Ecommerce				
2	Of which: Exempt B2B Ecommerce				
3	B2B non-exempt Ecommerce	$ 410.0	$ 529.5	$ 590.1	$ 657.8
4	Of which: EDI Sales	$ 281.0	$ 358.9	$ 400.1	$ 445.9
5	B2B Internet Auto Sales **	$ 67.0	$ 85.8	$ 95.7	$ 106.6
6	Remaining B2B Internet Sales	$ 62.0	$ 84.7	$ 94.4	$ 105.2
7	Other Internet B2B in Sales Tax States	$ 60.5	$ 82.6	$ 92.1	$ 102.6
8	Average sales tax rate: 6.4%				
9	Sales Tax Incurred	$ 3.87	$ 5.29	$ 5.89	$ 6.57
10	B2B Compliance Rate	85%			
11	Taxes Remitted By B2B Purchasers	$ 3.3	$ 4.5	$ 5.0	$ 5.6
12	B2B Taxes Unremitted By Purchasers	$ 0.6	$ 0.8	$ 0.9	$ 1.0

* States impose taxes almost exclusively on goods that represent final demand, i.e. are for final use by the end-purchaser. Thus, goods sold by manufacturers to other manufacturers or to wholesalers who do not take title can normally be regarded as entirely tax exempt. Similarly, sales by do not normally involve goods, and so the value of transactions in this category can also be treated as tax exempt for both sales and use taxes. For all these reasons, sales and use taxes fall on only a small portion of business to business sales.

** Tax compliance for auto sales is practically 100% because of vehicle registration requirements.

Source: US Dept of Commerce Census Bureau E-Commerce Report 2007; authors' projections based on historical growth rates for prior three years

III. B2C SALES: THE IMPACT OF MULTICHANNEL SELLERS

Not only did the Tennessee study greatly understate the proportion of sales arising from B2B ecommerce, by the same token, it necessarily overstated the size and impact of B2C ecommerce. But even correcting for the proper volume of B2C ecommerce, as is done in Table 4, the Tennessee study greatly underestimated the proportion of ecommerce sales by multi-channel sellers, *i.e.*, those with physical, as well as online, stores. There are two reasons why, at least in hindsight, the relevant Tennessee estimates are so flawed.

First, the so-called "dot-com bust" of early this decade put many of the then-new, pure-play online sellers out of business. At the time of the Tennessee study, the vast majority of online sales were by these newcomers. No longer is this true; as any examination of the Internet Retailer's annual listing of the top few hundred sellers online, only a handful are pure-play online operations, with this proportion dropping steadily, as more traditional brick and mortar retailers acquire a significant retail presence.

Second, and even more importantly, many of the largest and best-known offline retail stores had, at the time of the Tennessee study, established their online operations as separate subsidiaries in order to reposition themselves in the minds of investors interested in high-tech retailing. As a result, these retailers assumed that, as distinct

legal entities with no integration into traditional retail networks, their online operations lacked sales tax nexus even in the states where the parent company had physical stores. Thus, they thought, they did not have an obligation to collect taxes on sales anywhere but where the online entity itself possessed a physical presence – such as its headquarters.

Within just a few years, however, many retailers began folding their online and offline together, and a tax amnesty deal was struck. Most of the top online stores now belong to retail giants, such as Wal-mart, and are collecting sales tax in all states where the parent has a physical store.

These two factors – the demise of the pure-play online sellers and rise of single-entity multi-channel retailers – have vastly increased B2C tax collection rates beyond what the Tennessee authors observed in the marketplace of in 2000-01. What is less defensible, of course, is that their estimates have not been updated to reflect these tectonic shifts. Table 4 summarizes the effect of these factors as well as the estimated effect of sales tax exemptions (for food, pharmaceuticals, children's' clothing) and sales of automobiles where remittance of use-tax is virtually 100%.

Table 4 follows a similar logic to that used above for B2B sales, with the exception that for B2C, the Census Bureau's retail e-commerce data is provided more frequently and is more up to date; and though lacking the greater detail of their annual survey data, can be used to validate actual top line values through 2006; component values are derived from annual reports as far as 2005 and are projected forward based on historical trends.

As with the B2B table, the calculation shown below excludes auto sales as automatically requiring proof of use tax compliance for the autos to be registered and used. Then, in line 6, we exclude some 10% of sales as un-taxed by states, accepting the rather conservative estimate by the Tennessee study. Then, in line 9, we exclude sellers with nexus, using a proportion derived from the E-Commerce reports' data on sales by non-store retailers vs. retailers with stores, even though many such non-store retailers actually have a multiple-jurisdiction retail presence – just not sufficient to be so categorized by the Census Bureau. A *de minimus* voluntary tax compliance rate of about 1% is applied to the value of sales tax incurred on these purchases.

Table 4: B2C Ecommerce

		Actual	Projected		
	B2C Ecommerce	**2005**	**2006**	**2007**	**2008**
1	**Retail E-Commerce--All States**	**$ 93.0**	**$ 114.0**	**$ 137.0**	**$ 163.7**
2	Auto Sales	**$ 17.0**	$ 22.0	$ 27.9	$ 35.2
3	Auto Sales Percent	18.3%	19.3%	20.4%	21.5%
4	**Other Internet**	**$ 76.0**	**$ 92.0**	**$ 109.1**	**$ 128.5**
5	**Other Internet –Sales Tax States**	**$ 74.1**	**$ 89.7**	**$ 106.4**	**$ 125.3**
6	% Exempt B2C Sales	10.4%	10.5%	10.6%	10.7%
7	Amt of Exempt B2C Sales	**$ 9.7**	$ 12.0	$ 14.5	$ 17.5

8	**Non-Exempt B2C**	**$ 64.4**	**$ 77.7**	**$ 91.9**	**$ 107.8**
9	Remote Sellers w/nexus	$ 19.3	$ 24.7	$ 31.0	$ 38.6
10	Pure play Remote Sellers	$ 45.1	$ 53.0	$ 60.9	$ 69.2
11	**Average sales tax rate: 6.4%**				
12	**B2C Sales Tax Incurred**	**$ 2.9**	**$ 3.4**	**$ 3.9**	**$ 4.4**
13	B2C Compliance Rate	0.75%	0.89%	1.02%	1.16%
14	**Taxes Unremitted By Consumers**	**$ 2.9**	**$ 3.4**	**$ 3.9**	**$ 4.4**

Source: US Dept of Commerce Census Bureau E-Commerce Report 2007; authors' projections based on historical data

IV. CONCLUSION

The 2000-01 Tennessee study vastly overstated currently uncollected sales/use tax revenue. As can be seen in Table 5, summing the calculations of B2B and B2C sales and taxes owed based upon the most comprehensive and up to date Department of Commerce data now indicate that nationwide only $3.5 billion was likely still outstanding from remote sales in 2005, and that this amount will reach only $4.8 billion in 2007, and $5.4 billion in 2008.

Table 5: Total Unremitted tax on Ecommerce Sales ($billions)

	2005	2006	2007	2008
B2B Taxes Uncollected	$ 0.6	$ 0.8	$ 0.9	$ 1.0
B2C Taxes Uncollected	$ 2.9	$ 3.4	$ 3.9	$ 4.4
Total Taxes Uncollected	**$ 3.5**	**$ 4.2**	**$ 4.8**	**$ 5.4**

Source: US Department of Commerce and Author's calculations, described herein.

As can further be seen from Table 6, these figures based on up to date Commerce Department data are but a fraction of the $45 billion originally projected by the 2001 University of Tennessee study for 2006 – an amount that states still find it in their interest to cite, even though it was a figure the Tennessee authors subsequently revised downwards to $19 billion – and even this amount we now recognize to be almost five times too high.[3]

Table 6: Comparison to 2000-01 Tennessee Studies

UNCOLLECTED ECOMMERCE SALES TAX	2006
Tennessee Study 2000 (based on Forrester Data)	**$45.4**
Partially Corrected Tennessee Study 2001 (based on Forrester Data)	**$19.2**
DMA Study 2007 (based on US Commerce Dept. Data)	**$4.2**

Of course, states are less concerned with national totals than the amounts that would accrue to them. To see the relevant impact on individual states, Table 7 provides a side by side comparison of the estimated amounts of unremitted use tax, taking the totals from the original and partially corrected University of Tennessee studies, and the present analysis of Dept. of Commerce data, and apportioning to individual taxing states on the basis of state share of total US GDP.

[3] Bruce and Fox (2001) p. 6

Table 7: State By State Comparison Of Unremitted Use Tax

State/Data Source	2006				
	State GDP as % of GDP for all Sales Tax States	Original University of Tennessee	Revised University of Tennessee	DMA Analysis of Census Bureau Data	If SSTA only/Join SSTA
Alabama	1.3%	$604.3	$256.67	$56.15	$10.9
Arkansas	1.1%	$488.0	$207.27	$45.34	$8.7
Arizona	1.8%	$799.2	$339.45	$74.25	$14.8
California	13.2%	$5,952.0	$2,528.04	$553.01	$171.6
Colorado	1.5%	$686.4	$291.54	$63.77	$12.5
Connecticut	1.4%	$648.9	$275.61	$60.29	$11.8
D.C.	0.3%	$123.1	$52.29	$11.44	$2.1
Florida	7.1%	$3,214.0	$1,365.11	$298.62	$75.0
Georgia	3.4%	$1,517.8	$644.67	$141.02	$30.3
Hawaii	0.8%	$359.2	$152.57	$33.37	$6.3
Iowa	0.8%	$372.3	$158.13	$34.59	$6.3
Idaho	0.3%	$151.5	$64.35	$14.08	$2.6
Illinois	4.0%	$1,795.3	$762.53	$166.80	$36.8
Indiana	1.6%	$728.5	$309.42	$67.69	$12.3
Kansas	1.0%	$451.5	$191.77	$41.95	$7.6
Kentucky	1.2%	$535.5	$227.45	$49.75	$9.0
Louisiana	2.2%	$1,008.1	$428.18	$93.66	$19.1
Massachusetts	1.5%	$683.0	$290.10	$63.46	$12.5
Maryland	1.5%	$664.3	$282.15	$61.72	$12.1
Maine	0.3%	$146.4	$62.18	$13.60	$2.5
Michigan	3.8%	$1,696.2	$720.44	$157.60	$28.7
Minnesota	2.0%	$920.6	$391.01	$85.53	$15.6
Missouri	2.0%	$884.1	$375.51	$82.14	$16.5
Mississippi	1.0%	$462.8	$196.57	$43.00	$8.2
North Carolina	2.2%	$1,010.9	$429.37	$93.92	$17.1
North Dakota	0.2%	$87.6	$37.21	$8.14	$1.5
Nebraska	0.5%	$238.7	$101.39	$22.18	$4.0
New Jersey	2.5%	$1,150.0	$488.45	$106.85	$19.4
New Mexico	1.0%	$440.2	$186.97	$40.90	$7.8
Nevada	1.0%	$441.7	$187.61	$41.04	$7.9
New York	7.9%	$3,569.2	$1,515.98	$331.62	$85.8
Ohio	3.3%	$1,502.2	$638.04	$139.57	$29.9
Oklahoma	1.5%	$670.6	$284.83	$62.31	$11.3
Pennsylvania	3.3%	$1,503.4	$638.55	$139.68	$29.9

Rhode Island	0.3%	$124.5	$52.88	$11.57	$2.1
South Carolina	1.2%	$525.0	$222.99	$48.78	$9.4
South Dakota	0.3%	$133.4	$56.66	$12.39	$2.3
Tennessee	2.7%	$1,242.8	$527.86	$115.47	$24.1
Texas	8.8%	$3,957.0	$1,680.69	$367.65	$98.2
Utah	0.8%	$359.0	$152.48	$33.36	$6.3
Virginia	1.8%	$817.0	$347.01	$75.91	$1.2
Vermont	0.2%	$71.7	$30.45	$6.66	$1.2
Washington	3.2%	$1,427.3	$606.23	$132.61	$28.2
Wisconsin	1.6%	$721.5	$306.45	$67.04	$13.2
West Virginia	0.5%	$232.4	$98.71	$21.59	$3.9
Wyoming	0.2%	$85.2	$36.19	$7.92	$1.5
TOTAL	**100%**	**$45,204.3**	**$19,200**	**$4,200.0**	

It is also possible – though highly unlikely – that Congress might be persuaded to alter the law on nexus only for those states that are fully compliant with the State Streamlined Sales Tax Agreement (SSTA). Thus for comparative purposes, the last column of table 7 reports the portion of unremitted use tax accruing to states that are currently fully certified (2007) members of SSTA, or if they are not, the amount that would accrue if they were the next state to join this group. (Note: state values in this column assume each state was the incremental addition to the original SSTA members, so will not sum).

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August 4, 2000

Frank Shafroth
National Governors Association
Streamlined Sales Tax Project
444 N. Capitol Street, NW, Suite 425
Washington, DC 20001-1538

RE: Direct Marketing Association - Sales/Use Tax Reform Proposals

Dear Frank:

On behalf of the Direct Marketing Association, please find enclosed several sales/use tax reform proposals which it believes should be incorporated into any interstate compact designed to simplify and harmonize the existing morass of disparate state sales/use tax laws. DMA recognizes that the existing system arose in an economic environment significantly different than that which now confronts interstate marketers. Both states and multistate merchants are now at an historical juncture where their combined efforts, along with those of Congress, could result in a substantially reformed sales/use tax system designed for the commercial and revenue needs of the 21st Century.

It is my understanding that the NGA's Streamlined Sales Tax Project will explore possibilities for substantial reform of state and local sales/use taxes, and that the results of those efforts will form the basis for further discussions with industry representatives and appropriate congressional committees. The Direct Marketing Association is prepared to be an active participant in this process and to engage in a constructive dialogue with state and local government officials to re-engineer the existing tax system to better serve the interests of both government and electronic commerce merchants.

I assume that you are the appropriate contact person for the Streamlined Sales Tax

Project. After you and the other government representatives have had an opportunity to review the enclosed proposals, I would appreciate your contacting me and advising how DMA can best engage in direct discussions with the state representatives on these issues and work together toward a simplified sales/use tax system. I look forward to your response.

Very truly yours,

BRANN & ISAACSON, LLP

George S. Isaacson

GSI/dmg

Enclosure

Tax Reform Proposals
For Submission To States' Streamlined Sales Tax Project

I. TAX RATES
- A. Rate Structure
  1. One tax rate per state for all commerce.
- B. Frequency Of Rate Changes
  1. 120 day advance notice of rate changes.
  2. Rate changes only on January 1 and July 1.

II. TAX BASE
- A. Greater Uniformity Of Tax Base
  1. Common definitions of taxable and exempt products.
  2. Commitment among Participating States to adopt a uniform tax base within 10 years.
  3. Elimination of tax on shipping and handling charges.

III. TAX FORMS
- A. Standardized Forms
  1. Single multi-state registration form.
  2. Single multi-state spreadsheet-style remittance form.
  3. Standard resale certificate (no state modifications or varying certificate numbers).
  4. Standard exemption certificate and common database of exempt organizations.

IV. CENTRALIZED ADMINISTRATION
- A. Centralized Filing For Each Multi-State Vendor
  1. One central registration point applicable to all Participating States.
  2. One spreadsheet-style remittance report covering all Participating States.
- B. Administrator State - Each Multi-State Vendor Must Select A Participating State As Its Administrator State
  1. Administrator State is the filing point for all registrations and remittances.
  2. Administrator State authorized to conduct audits of the multi-state vendor on behalf of all Participating States.
- C. Audits
  1. A single audit on behalf of all Participating States is conducted by the Administrator State (unless the vendor requests to be audited by each individual taxing state).
  2. Audits will be conducted no more frequently than once every two years, unless there is reasonable basis to believe that there is fraud or financial insolvency.
  3. Each Participating State must give a multi-state vendor the option of submitting a protested tax assessment to a mediation-arbitration process in lieu of pursuing administrative appeals and judicial review in the individual taxing state.

V. LIMITATION ON VENDOR LIABILITY
- A. A retailer shall not be liable to a taxing state for uncollected use taxes if the customer fails to remit to the retailer the applicable tax amount in the following circumstances:
  1. Customers paying by credit card:
     - a) The retailer determined the applicable tax by using tax collection software certified by the state.

2. Customers paying by check or money order:
   a) The retailer provided a general notice in its advertising that applicable use tax should be included with payment.

B. Uniform Bad Debt Provisions

VI. VENDOR DISCOUNT

A. Reasonable Reimbursement Of Retailer Collection Costs
   1. The vendor discount should be increased and standardized among the Participating States to reflect the actual average costs of collection to retailers.
   2. Increased vendor discount should be applicable to all retailers.
   3. Joint state government-retail industry panel should be established to determine the real collection costs incurred by vendors (perhaps by different categories of retailers), with an on-going responsibility to recommend adjustments in vendor discounts as cost elements change over time.

VII. SOURCING

A. Gift Transactions
   1. In third-party donee transactions, no use tax should be imposed unless the purchaser and the donee are located in the same state.

VIII. CONSUMER PRIVACY

A. Limits On Demands For Consumer Information
   1. States should not be allowed to require vendors to obtain any information from consumers other than that which is necessary for completion of the sales transaction.

B. Limits On Use Of Consumer Information
   1. States may not use personally identifiable consumer-provided information for any purpose other than determination of use tax liabilities.
   2. States will conform to privacy assurance standards and procedures (both as to audit practices and data storage) established by an independent certifying agency which will annually report on state compliance with the established standards.

IX. *DE MINIMIS* EXCEPTION FOR REMOTE SELLERS

A. National Sales By A Remote Seller Before Being Subject To Collection Duties
   1. Ten million dollars (CPI adjusted based on Year 2000).

B. State Sales By A Remote Seller Before Being Subject To Collection Duties For That State
   1. Five hundred thousand dollars (CPI adjusted based on Year 2000).

X. ADOPTION OF SIMPLIFIED AND UNIFORM LAW BY CRITICAL MASS OF STATES

A. Number Of States
   1. 30, plus

B. Percentage National Population
   1. 70% of national population must reside in those states.

XI. FEDERAL COURT JURISDICTION REGARDING UNCONSTITUTIONAL STATE TAXATION

A. Tax Injunction Act
   1. Amend Tax Injunction Act to grant federal court jurisdiction over cases in which it is alleged that a state tax law or practice violates the U.S. Constitution.

B. Recovery of Attorney Fees

1. As in other cases where a plaintiff proves a state violation of a federally-guaranteed right, permit taxpayers in actions alleging a violation of their constitutionally protected rights to collect their attorney fees if successful in the litigation.

ANNOTATIONS FOR TAX REFORM PROPOSALS

I.A.1 - Multiple state and local tax rates are burdensome for all multi-state retailers, including for those which have nexus in numerous states (many DMA members fall into this category), and the great variety of rates are confusing to consumers. True tax simplification must begin by eliminating the ever-expanding number of tax jurisdictions. This was a reform measure unanimously agreed upon during the NTA Project.

I.B.1 and 2 - Catalog companies need long lead times because of lay-out and printing requirements to change their catalog copy and order forms regarding customer tax obligations.

II.A. 1 and 2 - The disparate tax base among various states is one of greatest causes of customer confusion and vendor compliance error. States should move towards substantially greater uniformity in their tax bases.

II.A.3 - The disparity among the states regarding taxation of shipping and handling charges is especially confusing to consumers, and it forces catalog companies to develop complex order forms (which look more like tax forms). As a service, delivery charges should be eliminated from the tax base.

III.A.1,2,3 and 4 - Standardization of forms is one of the easiest and least painful steps for the states to take.

IV.A. 1 and 2 - Centralized filing, with only one compliance point of contact for each retailer, is a simple and logical step towards administrative simplificaton.

IV. B. 1 and 2 - An Administrator State or "base state" system substatially reduces the administrative complexity of tax administration for multistate retailers. It has worked well for the states and the Canadian Provinces in regard to the state and provincial fuel tax obligations of interstate and international trucking firms. To the extent that states expect interstate marketers to be able to comply with a variety of state use taxes, then it is certainly appropriate to expect that the revenue departments of the Participating States will be able to administer the system (especially if simplified) on behalf of their sister states.

IV.C.1 and 2 - A single audit by the Administrator State on behalf of all Participating States can reduce the time and expense of coping with multiple use tax audits. Similarly, by limiting the frequency of audits (but permitting audits well within each state's statute of limitations), the burdens and interuptions of multiple state tax audits is reduced.

IV.C.3 - Forcing an out-of-state retailer to hire local counsel and proceed through the arcane administrative and appeal procedures of a foreign jurisdiction is one of the principal concerns of interstate retailers regarding collection of state use taxes. An elective mediation process, followed by binding arbitration of taxpayer protests, would be a quick and cost-efficient means to allow remote sellers to obtain a fair resolution of their contested assessments. Currently, many state administrative and judicial appeal procedures are simply too slow and too expensive to

permit a remote seller to challenge the assessment.

V.A.1 - Changes in tax rates and taxable products present the risk that vendors will err in the calculation of applicable taxes. Certified tax collection software reduces that risk and its economic consequences.

V.A.2 - In contrast to a traditional consumer transaction conducted over a sales counter, in the remote sales context, a customer may not necessarily include the applicable sales tax in his payment, despite being asked to do so by the vendor. This is especially problematic where payment is made by check and the customer errs in his self-calculation of the tax. In those circumstances, post-sale collection of the tax is prohibitively expensive for the retailer.

V.A.B - A retailer should not be obligated to remit use tax to a state on the full value of a customer order when the retailer does not collect full payment from its customer. Currently, there is no consistent treatment of bad debts among the states. Retailers are often left holding the bag on state taxes. Similarly, on installment sales, the tax should be remitted to the state on a proportional basis as payments are received by the retailer from the consumer.

VI.A. 1, 2, and 3 - There is no policy justification for retailers being forced to subsidize the states for the expense of collecting use taxes from state residents. If states believe that retailer-collection of use taxes is the most efficient means of collecting those taxes (as compared to efforts by the states to collect the tax directly from their citizens), then the states should reimburse retailers for all the costs they incur in administering the tax collection system on behalf of the states. Indeed, in the states' "Zero Burden Proposal" before the Advisory Commission On Electronic Commerce, it was stated that the states should assume all the expense of use tax collection administration.

VII.A.1 - Many remote consumer sales involve situations where the buyer is not the recipient of the product being delivered (e.g., holiday season gifts sent to family members). Where the buyer and the donee are located in different states, there should be no use tax imposed on the transaction. (The buyer is not "using" the product in his home state, so no tax should be imposed by that state; and the donee is not the purchaser of the product, so the donee state should not impose a tax on the recipient of a gift.)

VIII.A.1 and B.1 - A reasonable de minimis threshold will minimize the deterrent effect of use tax collection on new business entering the electronic commerce marketplace.

IX.A.1 and B.1 - A reformed sales/use tax system designed to acieve substantial simplification and greater uniformity does little good if it is not widely - indeed, almost universally - adopted by the states.

X.A.1 - If state tax laws are to be given expanded national scope, then the national court system should be given authority to hear claims that the administration of those tax laws violates the federal constitution. This is especially important where the taxpayer is not a resident of the state imposing the tax obligation.

X.B.1 - Statutory provisions for the recovery of attorney fees are not only intended to reimburse successful plaintiffs for the litigation costs they incurred; such laws are also intended to deter parties (including states) from violating the constitutional rights of individuals and businesses. Any expansion of state tax authority to remote sellers carries a significant risk of new violations of constitutional law. (Indeed, case precedent is already replete with examples of state tax administrators violating the constitutional rights of taxpayers.) The threat of paying a successful litigant its attorney fees would be an important constraint on state revenue department abuse of taxpayer rights.

XI.A.1 - Many aspects of electronic commerce are instantaneous and anonymous, including some forms of payment. The growth and development of electronic commerce should not be impeded by state revenue department demands for the collection of consumer information which goes beyond that which is necessary for completion of the transaction.

XI.B.1 - American consumers are entitled to strict procedures and ironclad assurances that the information obtained by government officials will only be use for the intended purposes and not inappropriately disseminated or shared with other government agencies or private entities.

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September 12, 2007

VIA EMAIL & U.S. MAIL

Scott Peterson
Executive Director
Streamlined Sales Tax Governing Board, Inc.
4205 Hillsboro Pike
Suite 305
Nashville, TN 37215

RE: Alternative Sourcing Proposal

Dear Scott:

As you know, I am tax counsel for the Direct Marketing Association ("DMA"), the nation's largest trade organization representing remote sellers, many of whom collect and remit use taxes to Streamlined Sales Tax Member States. Please accept this letter as a position statement on behalf of the DMA in opposition to the Alternative Sourcing Proposal which will be considered by the Streamlined Sales Tax Governing Board at its September 19-20 meeting in Kansas City.

My understanding is that the proposal under consideration is to amend Section 310 of the Streamlined Sales and Use Tax Agreement, which currently requires that all Member States use "destination sourcing" (i.e., location of the purchaser where products are delivered) for all sales, both interstate and intrastate. The proposed amendment would abandon the mandatory "destination sourcing" rule and, instead, permit Member States to adopt a two-tiered-optional-rate sourcing protocol. This new optional rate would apply only to the local portion of combined state and local use taxes and would require a Member State to apply "origin sourcing" to all intrastate sales, while requiring adoption of a combination rate for interstate sales, which could be as much as the sum of the state rate plus the highest local rate applicable within the state, irrespective of the actual tax rate in effect where the purchaser is located.

The DMA is strongly opposed to this amendment, which it believes is both confusing and discriminatory. A principal objective of the Streamlined Sales Tax Project was to achieve

simplicity, consistency and greater uniformity in the substance and administration of state sales and use tax laws. A single protocol for sourcing taxable transactions was critical to achieving that goal. Now, seven years after the launch of the streamlining project, a change in the SSUTA that would permit Member States to adopt different sourcing rules for state level taxes (destination sourcing) and local level taxes (origin sourcing) would be a major step backwards. Such a departure from uniform sourcing standards would cause confusion and serve no valid tax policy purpose.

Most significantly, the proposed amendment creates a distinction between the treatment of intrastate commerce and interstate commerce. This is the very evil that the Constitution's Commerce Clause (Art. I, § 8, cl. 3) was intended to prevent. The Supreme Court has been vigilant and adamant in barring such discriminatory treatment. In *Associated Industries of Missouri v. Lohman*, 511 U.S. 641 (1994), a unanimous Supreme Court concluded that Missouri's statewide uniform use tax violated the Commerce Clause by discriminating against interstate commerce in those localities where the uniform use tax exceeded the local sales tax rate. Writing for the Court, Justice Thomas opined:

> Missouri's use tax scheme, however, runs afoul of the basic requirement that, for a tax system to be "compensatory" the burdens imposed on interstate and intrastate commerce must be equal. ... But in Missouri, whether the 1.5% use tax is equal to (or lower than) the local sales tax is a matter of fortuity, depending entirely upon the locality in which the Missouri purchaser happens to reside. Where the use tax exceeds the sales tax, the discrepancy imposes a discriminatory burden on interstate commerce. ... The resulting disparity is incompatible with what we have termed the 'strict rule of equality ...'[1]

The elimination of confusing, cumbersome and convoluted tax schemes was an overriding objective of the Streamlined Sales Tax Project. This latest proposed convolution, however, which calls for different sourcing schemes at the state and local levels, and different treatment of intrastate and interstate commerce, is counter-productive and would undermine foundational principles of tax simplification for businesses and consumers. True tax reform can best be accomplished by limiting each Member State to one tax rate per state for all commerce. The DMA has consistently supported such tax reform, and it urges the Governing Board to reject

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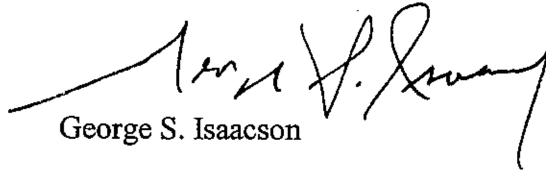
[1] The Alternative Sourcing Proposal's provision that a purchaser can seek a refund or a credit from the state for any overpayment of taxes does not cure the constitutional defect. The initial facial discrimination is constitutionally fatal, and, moreover, it is neither practical nor fair to impose on consumers the added burden of applying for refunds to state revenue departments for the relatively small individual transaction amounts to which they may be entitled.

the Alternative Sourcing Proposal and, instead, adopt the one rate per state rule that the DMA has long advocated.

Thank you for the Governing Board's consideration of these comments.

Very truly yours,

BRANN & ISAACSON



George S. Isaacson

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