Questioning the Viability of the Sales Tax: Can It Be Simplified to Create a Level Playing Field?

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I appreciate the opportunity to speak to you. I would like to go on record as saying that it would warm my wife’s heart to hear me introduced as the former chair of the Utah State Tax Commission. Whenever I was at a social event with my wife and was asked, “What do you do?” I would respond, “I am the chairman of the Utah State Tax Commission.” In my wife’s mind, my position was the medical equivalent of the endowed chair for the venereal diseases. So, she would hope that I would not be asked the next question, which was “What do Tax Commissioners do?” I would give a long dissertation as my wife would fade into the crowd.

Governor Leavitt has been out in front of the Internet taxation issue. If you study what he has written and what he has said, and if you listen to his State of the State address on Monday night, particularly to what he will say about Internet sales taxation, you will find that his position is the following: The sales tax system in its present form is complex, is burdensome, is in need of repair, and if it cannot be repaired to create levelness and fairness, it should be scrapped. It is his position that any additional revenues generated from the taxation of remote sales should reduce taxes and not be used to expand government. For Governor Leavitt, a level playing field means that all businesses or no businesses collect sales tax and that it is time to simplify and establish fairness in the sales tax system.

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1. After the presentation of this paper, Governor Leavitt issued his State of the State address and thereafter issued a proclamation calling for the “eventual elimination of the sales tax on food, or other reductions in existing sales and use tax burdens, as additional revenues on remote sales are generated from taxes currently owed but not collected.” Michael O. Leavitt, Executive Order Assigning the Tax Review Commission to Study and Make Recommendations Concerning Sales and Use Tax (Jan. 18, 2000) (on file with author).
Thus, the real issue from a tax policy perspective is whether the sales tax is a viable funding vehicle for state and local government in the twenty-first century economy.

My one regret in taking over as Chief of Staff for Governor Leavitt is that I cannot deal with this issue on nearly a full-time basis. It is one of the most intriguing opportunities to simplify and harmonize tax policy in this century.

II. THE RAPID DEVELOPMENT OF THE INTERNET

Nearly 100 years ago, Alfred Marshall, a British economist, wrote in *The Principles of Economics*, “The full importance of an epoch-making idea is often not perceived in the generation in which it is made. . . . A new discovery is seldom fully effective, for practical purposes till many minor improvements and subsidiary discoveries have gathered themselves around it.”2 Marshall alluded to a phenomenon of new, subsidiary discoveries that follow many major discoveries. As a recent article in *The Economist* put it:

> Who could have imagined, when the first car rolled along a road, how that invention would alter shopping, urban design or courtship? When Faraday experimented with electricity, who foresaw the coming of the skyscraper, its lifts driven by electrical power, or the movement of women into the workplace, their domestic productivity transformed by the washing machine and vacuum cleaner? What connection did anyone make between the arrival of television and the future of political debate, or of branded goods?3

I believe we are on the threshold of these kinds of subsidiary discoveries in connection with the Internet.

Headlines regarding the Internet suggest that subsidiary discoveries are occurring at a remarkable pace. For example, newspapers are being dissected and unbundled. Newspapers rely upon classified advertising as a main source of revenue. The Internet, however, is also being used for classified advertising, and, as a result, specialized nationwide services are emerging. Newspaper editorial boards, staff, and management are planning their reaction to the Internet’s impact on one of their main revenue sources. These subsidiary discoveries present issues that historically have taken more than one career to see.

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3. *Id.*
through. And yet it is likely that one issue, taxation of remote transactions, will be resolved within the decade.

At this point, it is important to emphasize that the issue is neither the assessment nor the creation of new taxes. This issue relates exclusively to the collection of taxes. The United States Supreme Court has played an important role in establishing which businesses must collect sales tax. In *Quill Corp. v. North Dakota*, the Court held that a state can only require businesses with a physical presence in that state to collect sales tax. The Court therein essentially reiterated its decision in *National Bellas Hess, Inc. v. Department of Revenue of Illinois* twenty-five years prior. If you compare the relative similarity of the issues presented in *Quill* and *National Bellas Hess* with the weekly development of the Internet, you quickly realize that we are compressing time at a remarkable rate. Cases in point include AOL’s announced merger with Time Warner, AOL’s entering into a partnership arrangement with Wal-Mart, and General Motors and Ford’s announcement that they will devote tremendous resources to their entry into the Internet.

So, in this remarkable time, changes that Marshall anticipated would occur over a lifetime are occurring within very narrow time frames. It is very exciting. It is within this context that I address what is commonly referred to as the Internet sales tax issue but what is more properly characterized as the taxation of remote sales.

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4. *504 U.S. 298, 316 (1992)* (holding that requiring physical presence “in the area of sales and use taxes also encourages settled expectations and, in doing so, fosters investment by businesses and individuals”).

5. *386 U.S. 753 (1967)*, overruled on other grounds by *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). *Quill* did not, however, overrule the Court’s holding in *National Bellas Hess* that the Due Process Clause only permits states to collect sales tax from businesses that have a physical presence in that state. See *504 U.S.* at 308. Thus, the Due Process Clause does not preclude a state from requiring a company that “purposefully direct[s] its activities” at the state to pay a tax if the tax is “related to the benefits [the company] receives from access to the State.” *Id.* “Despite the similarity in phrasing [of the substantial nexus tests], the nexus requirements of the Due Process and Commerce Clauses are not identical.” *Id.* at 312. As the Court explained, “the Commerce Clause and its nexus requirement are informed not so much by [the Due Process Clause’s] concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy.” *Id.*
III. THE INTERNET PROVIDES AN OPPORTUNITY TO REEVALUATE THE STATE SALES TAX SYSTEM

While it is presently unclear where the Internet will ultimately take us, the Internet presents the unprecedented opportunity to examine, radically simplify, and greatly improve the states’ current sales tax system.

As we examine the current sales tax system, we should be clear that the issue is not whether the Internet itself should be taxed. Almost everyone agrees that Internet access, bandwidth, bytes, or bits should not be taxed. Rather, the issue is whether the taxation of sales on the Internet is consistent with the fundamental tax principle of a level playing field, federalism, states’ rights, devolution, and the movement toward simplification of the sales tax system.

It is expedient political rhetoric to ask Congress to prohibit a state sales tax on Internet sales under the banner of free trade. Such rhetoric is appealing. What citizen wants to pay what is perceived to be an additional tax? Moreover, what business engaged in e-commerce would willingly forego an aspect of its business that is most appealing to its customers?

Though appealing, exempting sales on the Internet from sales tax does anything but promote free trade. As Governor Leavitt stated, “Free trade means level playing fields, not special advantages. The prohibitionist campaign is an effort to give an unfair competitive advantage to one group of sellers. It is protectionism cloaked as free trade.” Moreover, asking Congress to prohibit state sales tax on sales on the Internet would strip “the states and local governments of their right to control their own tax policies. Thomas Jefferson would roll over in his grave.” States and local governments should determine how they will fund public education, public safety, highway maintenance, and other programs. Asking Congress to prohibit states sales tax on sales on the Internet also violates a fundamental principle of the Republican Party: devolution. As Governor Leavitt stated, “Asking Congress to roll over the most important of state roles is a clear invitation for an all-powerful federal government.”


7. Id.

8. See id.

9. Id.

168
addition, opposing tax on sales on the Internet does nothing to remedy the overly complicated state sales tax systems currently in place. Finally, those who oppose the taxation of Internet sales increase the appeal of their political rhetoric by characterizing the tax as a revenue protection measure when in fact it is not, as I will explain below.\textsuperscript{10}

Because the political rhetoric against state sales tax on Internet sales is so appealing, politicians who have argued for a level playing field and states’ rights have been lambasted in the press. Thus, it is not surprising that most politicians who in fact support state sales tax of sales on the Internet remain behind the scenes and have been unwilling to speak for tax fairness.

IV. THE HISTORY OF SALES TAX

It is helpful to briefly review the history of the sales tax to understand the current remote sales tax issue. The development of the sales tax system in Utah is comparable to the development of sales tax systems throughout the nation.

A. The Obligations the Sales Tax System Imposes Upon Businesses

For the consumer, the sales tax is almost irrelevant. When purchasing an item, the consumer pays one amount that includes both the purchase price and sales tax. From the business perspective, however, the sales tax system imposes various obligations.

The Utah sales tax system developed in the 1930s. It began in a depression era and started out innocently. Sales tax was imposed on the sale of tangible personal property over the counter, and the system imposed upon businesses the obligation of collecting the tax for the state. In Utah, the sales tax commenced at 2 percent and, by the way, remained 2 percent into the 1960s. Businesses originally collected sales tax in the form of aluminum tokens, a smaller denomination than the penny, which was 2 percent of many transactions. The payor would sometimes place the tokens in a jar at the point of sale. It was a very simple process.

The state ultimately imposed on businesses another obligation, such as submitting data to the state to confirm that the business had accurately collected the sales tax. The data collection system started, I believe, innocently enough as well. Its purpose was to reconcile the

\textsuperscript{10} See infra Part IV.
books of the business with the needs of the state and to ensure that the sales tax was collected accurately and fairly.

The state then imposed a third burden upon businesses. In effect, the state told businesses that if they collected sales tax inaccurately, they would be required to make up the difference. As a result, the audit trail that businesses were required to create to justify and validate the accuracy of their sales tax collection became significantly burdensome. AT&T could stand before you and, I believe accurately, tell you that the sales tax system today requires them to file in excess of 39,600 returns annually, which is one return for every 3.1 minutes of the business day. The burden on small business is proportionally the same.

Accordingly, the sales tax has, through time, become increasingly time consuming, complex, and burdensome. To make matters worse, the sales tax requires businesses to make sales tax-related decisions. If, for example, you live in a state that does not tax medicine, but taxes cosmetics, the purchase of Chapstick becomes problematic. Suppose a sixteen-year-old counter clerk is at the cash register with a customer who wants to buy Chapstick. This sixteen-year-old counter clerk must decide whether the Chapstick is “medicine” or whether it is a “cosmetic.” How would reasonable people expect the clerk to know the answer? Would the clerk need to quickly examine the customer and ask, “Do you have chapped lips?” If the customer responded affirmatively, it is possible that the Chapstick purchase is medicinal and, therefore, not taxable because it is being purchased to treat chapped lips. On the other hand, if the customer responds in the negative, then Chapstick is likely a cosmetic and would fall within an entirely different category, and would be taxable.

Given these burdens, businesses have over the course of time shown that they are willing to exert significant efforts in court to avoid shouldering these burdens when there are any circumstances that do not require them to do so.11 One result of these efforts is the United States Supreme Court’s holding in National Bellas Hess, reiterated in Quill, that a state cannot require an out-of-state retailer with no physical presence in the state to collect sales or use tax from residents of the state who purchase the out-of-state retailer’s prod-

ucts. The physical presence test is the standard by which states require businesses to collect sales tax, and it plays a major role in the remote sale issue generally and in the Internet sale issue specifically.

B. Avoiding Sales Tax

In the 1930s, people discovered that they could avoid paying sales tax by simply buying the same goods in another state that did not impose sales tax. In response, the forty-six states that collect sales tax now impose a use tax. Use tax is a tax upon goods purchased for consumption or use in the purchaser’s state of residence and for which the purchaser has not paid sales tax. Taxpayers are required to self-accrue this tax. It is a tax that by law should be reported and paid. Businesses pay use tax regularly in business to business transactions and are subject to audit.

As Professor Hellerstein mentioned in his address, however, few individuals comply. Of the eight hundred and seventy thousand individual returns filed with the state of Utah last year, only 3,619 Utahns filed for the use tax. This is less than one-half of 1 percent. Certainly, this figure does not accurately reflect the number of people who actually purchased goods on a remote basis. Most of those who do not remit this tax are simply unaware of the obligation to do so. In fact, I must confess that it was not until I became a Commissioner of the Tax Commission that I began to pay use tax. My wife still does not understand why I pay use tax. When she asks, “Why,” I respond, “If you stuck with me longer at the social events, you would know what I do for a living and know that this is a tax we owe!” If the State could appoint more people as Commissioners, even if temporarily, I am persuaded that we could more quickly increase the number of persons who pay use tax that they already owe!

12. See National Bellas Hess, 386 U.S. at 760. The Court reasoned,

"If the power of Illinois to impose use tax burdens upon National [Bellas Hess] were upheld, the resulting impediments upon the free conduct of its interstate business would be neither imaginary nor remote. For if Illinois can impose such burdens, so can every other State, and so, indeed, can every municipality, every school district, and every other political subdivision throughout the Nation with power to impose sales and use taxes. The many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle National [Bellas Hess’s] interstate business in a virtual welter of complicated obligations to local jurisdictions with no legitimate claim to impose “a fair share of the cost of the local government.”

Id. at 759-60.
C. The Erosion of the Tax Base

The first erosion of the tax base occurred when citizens began to purchase goods in states that did not impose a sales tax, as discussed above. Despite the implementation of the use tax, the tax base has continued to erode, some of the causes for which have been natural and non-legislative. One cause of erosion has been the natural shift in our economy from manufacturing to service. Because few services are taxable, this shift in the economy has resulted in fewer taxable transactions in the marketplace. Another non-legislative cause of erosion was the advent of catalog sales. The states’ effort to require businesses selling products by catalog to collect sales tax has been unsuccessful, as discussed above.13

The tax base has been further eroded by legislative changes that exempt certain items, individuals, or institutions from the sales tax. The legislature makes policy decisions in response to requests for exemptions. An example is prescription medicine, which is exempt in Utah. If the legislature agrees that the item (prescription drugs, for example), individual (such as farmers), or institution (such as charitable organizations) should be exempt, that item, individual, or institution is removed from the tax base. Since the 1960s, the Utah State legislature has exempted nearly fifty items, individuals, or institutions from the sales tax.

As the economic and market shifts and legislative changes eroded the sales tax base, sales tax rates have necessarily increased in order to adequately fund the fundamental operations of state and local government. And as sales tax rates have increased, the incentives for noncompliance or to seek an exemption have also increased.

The erosion of the sales tax base means that fewer people are paying sales tax at an increasing rate. In Utah, for example, the sales tax rate has grown from 2 percent to 6.35 percent in some jurisdictions. This trend will continue unless erosion of the sales tax base is curbed. If it is not, fewer and fewer people will continue to pay a higher sales tax rate. Basic tax policy calls for broad bases and lower

13. See Quill Corp., 504 U.S. at 298; see also National Bellas Hess, 386 U.S. at 753. It is important to remember that the issue has never been whether a person who purchases an item by catalog must pay tax on that purchase. If that person resides in a state that has a sales tax and uses or consumes the item in that state, they owe the state the appropriate use tax. The only issue regarding catalog purchases, therefore, is whether catalog businesses should be required to collect the tax.

172
rates. Whenever the State grants an exemption, the State has made a policy decision to prefer one taxpayer or product over another. This temptation to exempt taxpayers and products has created a system filled with inequity and tainted with special interest. While strong economies and increasing sales tax rates have masked the problems of the sales tax, the projected volume of business conducted on the Internet will only exacerbate the problems.

V. TAXING REMOTE SALES

When you enter any wilderness park in the West, you receive a brochure. The brochure describes how you should react if you encounter a bear. The brochure tells you to keep your pack on, to make yourself big, to wave your arms, to speak loudly, to back away slowly, and to avoid running from the bear. If the bear attacks, the brochure instructs you to assume the fetal position and protect your vital organs. I submit to you that right now many constituents are making themselves big, waving their arms, and speaking loudly. But, in a very short time, I submit, some of these same constituents will be assuming the fetal position and protecting their vital organs.

The following is an examination of the remote sales tax issue from a variety of perspectives, since perspective ultimately determines one’s position on sales tax on remote sales.

A. Businesses with Total Nexus

Some businesses have nexus everywhere. That is, some businesses have a physical presence in most, if not all, states. These businesses are the Barnes & Nobles and the Wal-Marts of the world. They face the development of the Internet in an interesting posture. Ideally, businesses with total nexus want all businesses, bricks-and-mortar and Internet alike, to be in the “tax club.” But, because all businesses are not in the “tax club,” the total nexus businesses have decided to employ marketing strategies that allow them to take advantage of the benefits afforded those not in the “tax club.”

From a marketing perspective, synchronous marketing would seem to be superior, but the current law on such remote sales has created an environment where businesses are driven to create strange configurations. When Gateway Computer began selling computers remotely, it initially collected sales tax on those sales. As Gateway has evolved into a bricks-and-mortar business, however, it has done an
about face and has concluded that it will market its products through two separate entities because it is now competing with Dell, who does not collect sales tax because they, like Land’s End, have nexus in only one state. Likewise, Wal-Mart has indicated that they will create entity isolation by establishing a separate Internet entity. They too will only collect sales tax from residents in those states where the separate entity maintains a warehouse or other place of business. Wal-Mart happens to maintain a warehouse in Utah; so, according to their business plan, they will collect sales tax from Utah residents.

In summary, the current sales tax system encourages total nexus businesses to play the nexus game in order to compete with those businesses with nexus in one or a few states so long as there is no obligation to collect sales tax on remote sales.

B. Businesses with Limited Nexus

What about the Amazon.coms of the world? There have been some interesting changes. Amazon.com, for example, started out in the state of Washington and collected sales tax only on sales to residents of Washington. But, over time, Amazon has begun to branch out, creating more distribution points in more states, thereby increasing the number of states in which it has nexus. Perhaps, in the end, the Amazon.coms of the world will evolve into total nexus businesses and those total nexus businesses that created separate Internet entities to avoid nexus will merge back into the bricks-and-mortar entities for marketing purposes. At present, however, businesses that have limited nexus enjoy a significant tax advantage to the extent they sell products to residents of states with which they do not have nexus. Moreover, these businesses do not bear the burden of collecting sales tax. It is safe to say that businesses with limited nexus will continue to oppose a sales tax on remote sales until they no longer benefit from this configuration.

C. Local Businesses

What about the independent downtown retailers and other local businesses? Many of these businesses claim to be hanging on by their fingernails as their customers turn to the Internet. Thus, local businesses are petitioning state governments, the Advisory Commission on Electronic Commerce (the “Advisory Commission”), and anyone else they can, for a level playing field. These businesses are arguing
that they cannot compete with the Amazon.coms who not only use volume to cut prices but do not collect sales tax (an additional six to seven percent advantage). If we are to believe experts like Lester Thurow of the Sloan School of Business at the Massachusetts Institute of Technology, half of the retail stores, many of which are found in downtowns, will disappear by the year 2010.\textsuperscript{14} Whether Mr. Thurow is accurate or not, it is a sobering thought. Will the Internet taxation issue change the landscape of our retail business, some of which have been in business for years? I offer the following example to suggest that it will.

I have two favorite bookstores, both of which are in downtown Salt Lake City: Sam Weller’s and The King's English. When you ask an employee at either of these stores about books, they can recommend books that they have \textit{actually read}. They can converse with you about the author and about the substance of the book. Unfortunately, however, both stores would tell you that the megastores, the stores offered subsidies in redevelopment projects, and now the e-tailers have had a dramatic negative impact on their business. They would also tell you that the Internet may ultimately put them out of business.

From a communitarian’s point of view, keeping in mind the unique flavors of a downtown, an argument can also be made that the Internet will change the character of our downtowns if a level playing field is not achieved for the bricks-and-mortar businesses. I am not suggesting that local businesses should be protected by way of tax incentives. But, conversely, the question remains whether granting a subsidy to e-tailers while denying a similar subsidy to local bricks-and-mortar business is fair. Clearly, the local bricks-and-mortar businesses favor the collection of sales tax on remote sales in order to create a level playing field.

\textbf{D. Local Governmental Entities}

Increasingly, local governmental entities have become dependent upon the sales tax. Like state governments with sales tax systems, local governments fear that they will have to alter the tax structure if the sales tax system fails to generate expected revenues. Altering the

tax structure may require increasing income and property tax rates, an unappealing prospect to all affected. Like local bricks-and-mortar businesses, local governmental entities favor collecting sales tax on remote sales.

VI. THE POLITICAL RESPONSE

The few politicians that have addressed Internet taxation and argued for a level playing field have quickly learned that the media will report this argument as an attempt at revenue protection. Such an interpretation of this argument is absolute, 100 percent bunk.

If states eliminate sales tax (as is the case in four states) or the sales tax system fails to generate sufficient revenue as business moves to the Internet, states will find some other revenue source to finance state and local government. The question is not whether a state will lose revenue if the sales tax system is eliminated, as some have characterized the issue. Rather, the question is what revenue streams the state will tap into to sustain state and local governments. If, in fact, sales on the Internet continue to increase without requiring the collection of sales tax, state and local governments will turn to alternative revenue sources. This would present very interesting policy issues.

I do not believe there is such thing as a preferred or “most congenial” tax. We are all concerned about taxes. But, when you compare the alternatives to taxing sales on the Internet—increasing income or property tax, for example—most tax scholars and most taxpayers would agree that including sales on the Internet in the sales tax system is rather appealing. People are not anxious to hear talk of raising property taxes; nor are they anxious to hear talk of raising income and other taxes. Thus, those who argue for the status quo do not fully understand the dilemma. The status quo is unacceptable. Either we rework the sales tax system for the twenty-first century or we do away with it altogether.

Politicians are not positioned to resolve this issue, and it is becoming evident that it will be resolved in the marketplace by the big players—Wal-Mart, JCPenney, The Gap, Circuit City, etc.—as they enter the Internet. Lou Gerstner, chief executive officer of IBM, recently stated, “The storm that’s arriving . . . is when the thousands and thousands of institutions that exist today seize the power of this
global computing and communications infrastructure and use it to transform themselves. That’s the real revolution.\textsuperscript{15} I absolutely agree. Wal-Mart, for example, by putting together mergers, creating partnerships, and forming strategic alliances, created a formidable force with which not only to sell goods on the Internet, but to distribute those goods to people in remarkable ways. When Wal-Mart brings its significant financial resources to the Internet, it will change the way the game is played, as will Circuit City, The Gap, Sears, and others. This is the next iteration that Alfred Marshall referenced as a subsidiary discovery. Thus, as the Internet becomes the new market place, as Mr. Gerstner suggests it will,\textsuperscript{16} the Internet will perpetuate and amplify the complexities and flaws of the sales tax system.

A story may illustrate this point. There were two men in a bar. The first man asked the second, “Hey, sounds like you’ve got an Irish accent. Are you from Ireland?” The second man replied, “Yes, I am.” The first man then asked, “Where are you from?” The second man replied, “I’m from Dublin.” To which the first man responded, “No kidding, so am I.” The first man then asked, “Where did you grow up?” And, the second man replied, “Well, I grew up on Cathedral Street.” The first man inquired further, “Down by the mall or up by the cathedral?” The second man answered, “I was closer to the mall.” The first man exclaimed, “I’ll be darned. I was, too. I was right down in the same neighborhood as you. Where did you go to school?” The second man answered, “I went to St. Mary’s.” To which the first man replied, “You’re kidding me. I went there, too. When did you graduate?” The second man answered, “1978.” The first man, in amazement, exclaimed, “We were classmates. I graduated in 1978, too.” At that point, another man walked into the bar and asked the bartender how things are going. The bartender replied, “Fine. Oh, the O’Malley twins are drunk again.”

I believe that this is the kind of rhetoric the Internet taxation issue is receiving in politics. It is easy for a politician to observe, like the bartender, that the Internet poses new sales tax issues and argue for an exemption to resolve those issues rather than accurately assess the issues, identify the consequences of sustaining the status quo, and constructively resolve those issues. Put another way, it is easier for a politician to support the appealing position of no Internet taxa-

\textsuperscript{15} When Companies Connect, supra note 2 (quotations omitted).

\textsuperscript{16} See id.
tion by making themselves big, waving their arms, and speaking loudly than to carefully consider the long-term implications of maintaining the status quo.

The events that have transpired at the Advisory Commission have been quite remarkable to watch. The National Tax Association E-commerce and Telecommunications Project (the “NTA Project”), in which I participated with Professor McClure and Professor Hellerstein, consisted of business representatives, government representatives, and scholars who met over the course of a couple years and discussed the impact and circumstances surrounding taxation of Internet transactions. It was a privilege to participate in the NTA Project. The project raised the level of discussion on sales tax issues, but business and government struggled to resolve the issues together because their views and perspectives were so diverse. But, the parties proved quite resilient and produced an excellent report that identified the seriousness and scope of the problem. The report was passed along to the Advisory Commission, which has convened and invited public participation by submitting proposals. The criteria by which the Advisory Commission will examine those proposals are the following:

[A.] Simplification

1. How does this proposal fundamentally simplify the existing system of sales tax collection . . . ?

2. How does this proposal define, distinguish, and propose to tax information, digital goods, and services provided electronically over the Internet?

3. How does this proposal protect against onerous and/or multiple audits?

[B.] Taxation

1. Does this proposal impose any taxes on Internet access or new taxes on Internet sales?

2. Does this proposal leave the net tax burden on consum-

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Questioning the Viability of the Sales Tax

cers unchanged?

3. Does the proposal impose any tax, licensing or reporting requirement, collection obligation or other obligation or fee on parties other than those with a physical presence in a particular state or political subdivision?

4. What features of the proposal will impact the revenue base of federal, state, and local governments?

[C.] Burden on Sellers

1. Does this proposal remove the financial, logistical, and administrative compliance burdens of sales and use tax collections from sellers?

2. Does the proposal include any special provisions with respect to small, medium-sized, or start-up businesses?

[D.] Discrimination

1. Does the proposal treat purchasers of like products or services in as like a manner as possible through the implementation of a policy or system that does not discriminate on the basis of how people buy?

2. Does the proposal discriminate against out-of-state or remote vendors or among different categories of such vendors?

[E.] International

1. How does this proposal affect U.S. global competitiveness and the ability of U.S. businesses to compete in a global marketplace?

2. Can this proposal be scaled to the international level?

3. How does this proposal conform to international tax systems, including those that are based on source rather than destination? Is this proposal harmonized with the tax systems of America’s trading partners?
[F.] Technology

1. Is the proposal technologically feasible utilizing widely available software to enable tax collection?

2. If so, what are the initial costs and the costs for required updates, and who is to bear those costs?

[G.] Privacy

1. Does the proposal protect the privacy of purchasers?

[H.] Sovereignty/Local Government Autonomy

2. Does this proposal respect the sovereignty of states and Native Americans?

3. How does this proposal treat local governments’ autonomy and their ability to raise a greater or lesser amount of revenues depending on the needs and desires of their citizens?

[I.] Constitutional

1. Is the proposal constitutional?18

The “Big Seven,” a group of government associations which include the National Governors’ Association, the National Association of the League of Cities and Towns, the national Council of Mayors, and others, submitted a proposal to the Advisory Commission.19 Professor Hellerstein spoke about this proposal, which is to streamline the sales tax system for the twenty-first century. The proposal seeks to remove the seller’s burden in collecting and accounting for sales tax. Many people would read Quill to say that the Internet taxation issue cannot be solved by the Advisory Commission and that it can only be solved by Congress.20 The proposal, however,


20. See Quill Corp. v. North Dakota, 504 U.S. 298, 318 (1992) (“This aspect of our decision is made easier by the fact that the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve.”).
objectively looks at *Quill* and *National Bellas Hess* as a roadmap rather than as a blockade. That is, the proposal seized the opportunity to respond to the Court’s concern in *Quill* and *National Bellas Hess* that it was too burdensome to require remote sellers to collect sales tax and proposed a simplified sales tax system.21

The streamlined sales tax proposal incorporates a “real-time” tax system. The system adds an additional step to the typical credit card transaction. In a credit card transaction, the seller retains the amount of the sale less the percentage of the sale that goes to the appropriate credit card companies that process the transaction. Real-time tax would permit a third party to also automatically deduct from the seller’s amount the sales tax due on the sale. The third party would collect the tax, provide the data associated with the tax, transmit the tax to the appropriate state, and be subject to audit. The question is whether technology can support it. This is a debatable proposition, but there are enough people who have come forward to suggest that the technology does exist and that it is worth exploring. I have spent a fair amount of time with those familiar with the technology and believe that the real-time tax system is a viable possibility if there is an incentive and opportunity to develop the system.

One of the most critical aspects of the proposed streamlined sales tax system is that it requires states to simplify their sales tax system as a prerequisite for participating in the system. There are those in the economic community that believe that the Internet needs time to develop. Most economists and scholars, however, are persuaded that requiring the collection of taxes on Internet transactions is inevitable and that at some point it will be necessary for businesses to collect sales tax. Accordingly, the streamlined sales tax proposal supports the status quo for three to five years as the states develop simplified and workable sales tax systems, the Internet develops, and market forces continue to shape the Internet.

21. See *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753, 759 (1967) (“[I]f the power of [a state] to impose use tax burdens upon National [Bellas Hess] were upheld, the resulting impediments upon the free conduct of its interstate business would be neither imaginary nor remote. For if [one state] can impose such burdens, so can every other State, and so, indeed, can every municipality, every school district, and every other political subdivision throughout the Nation with power to impose sales and use taxes. The many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle National [Bellas Hess’s] interstate business in a virtual welter of complicated obligations to local jurisdictions with no legitimate claim to impose ‘a fair share of the cost of the local government.’”).
I believe this issue will evolve as follows. The Advisory Commission meets in March and will attempt to put together a final proposal. Given the composition of the committee and the number and breadth of proposals presently before it, it is unlikely that the Advisory Commission will achieve a focused solution to the problem. Because the issue is complex and resolution will require a significant amount of effort, it may simply be too difficult to reach consensus. While there is optimism in developing a system based on common principles that may unite this group, the Advisory Commission bears an onerous burden, and it is unfair to expect the Advisory Commission to produce a proposal that no other group has been able to produce to date.

During the balance of this congressional term, the legislature will likely consider some legislation, but, for a number of reasons, not the least of which that this is an election cycle, I do not believe that Congress will pass legislation this session.

Next Christmas I believe we will see an amplification of what happened this Christmas. The growth of Internet sales will increase at a rate that will astound us. I believe even those who predicted increased Internet sales for this past Christmas grossly underestimated what actually occurred. There were fairly consistent updates of Christmas sales data that suggested that sales would be much higher than was predicted. If we go through a couple more Christmas cycles where downtown retailers, mall associations, and the Wal-Marts of the world continue to collect sales tax under the current system, bricks-and-mortar retailers will weigh in with demands for a level playing field. This will include bricks-and-mortar retailers who have not yet made their voices heard on the issue. When these retailers come forward, the solutions will begin to take shape as the problem is solved in the marketplace.22

VII. CONCLUSION

If states simplify their sales tax systems during the next three to five years and successfully expand the duty to collect sales tax on remote sales, I am hopeful that the states’ sales tax systems will be fair and operate on a level playing field. Moreover, states’ rights will be protected, and states will not have to turn to other sources of reve-

22. For a detailed discussion of this evolution, see Governor Michael O. Leavitt, Address to the National Press Club (November 16, 1999) (on file with author).
nue to finance state and local government.

If, on the other hand, the states do not salvage the sales tax system at the end of this period (and Professor Hellerstein stated that he was not optimistic that they could), I believe that states will, under the same arguments of fairness, have no alternative but to eliminate the sales tax and consider other sources of revenue. If states do so, most of those who made themselves big, waived their arms, and spoke loudly will out of necessity assume the fetal position and protect their vital organs as they suffer the consequences of a system unfavorable to their particular business structure. There is no way to predict with certainty how this issue will be resolved, but one thing is clear: the ultimate decision should, at its conclusion, reflect sound tax policy and a level playing field. No form of business should be preferred and no unnecessary impediment to business should be permitted. What this suggests is that the level playing field will require sales tax to be collected by all sellers or not to be collected at all.