



State Sales and Use Tax Simplification

What is the Challenge?

The current moratoria on Internet access taxes has recently been extended by two years. Without this action by Congress, the bias towards various taxes on the Internet directly or that tax e-commerce and not other streams of commerce could return. Both taxes on access and discriminatory taxes widen the digital divide by hampering those at the margins from participating in the digital revolution.

Absent Congressional approval, the U.S. Supreme Court in *Quill* has held that states cannot require out-of-state merchants without a physical presence in the state to collect and remit sales tax on sales made to residents in the state. While the states desperately want this authority, **Congress must require the states to simplify their complex sales and use tax systems before granting authority to the states to burden out-of-state merchants with no physical presence in the state.** Simplification must be sufficient so that these taxes no longer pose an undue burden on interstate commerce. The states must then convince Congress that their efforts have succeeded in removing the undue burden on interstate commerce that the *Quill* court found existed. The states have engaged in various efforts in recent years to simplify their systems but so far they have not proven successful.

Do the moratorium and state simplification need to be tied in the same legislation?

The simple answer is no. However, the simple answer does not tell the whole tale. Contrary to myth, the Moratorium does not affect the ability of states to collect sales and use taxes. The Moratorium prohibits states from imposing multiple and discriminatory taxes on electronic commerce and from imposing taxes on Internet access. Hence, extending the moratorium would not affect states ability to continue efforts to simplify their complicated tax structures.

The moratoria are fundamentally important. Simplification is fundamentally important. If simplification were to be included in legislation addressing the extension of the current moratorium then certain principles should be followed. If simplification is not included in the moratorium extension then the issue should be pursued later.

Why should states simplify their tax complexity?

States must first simplify their sales and use tax systems and provide bright line business activity tax nexus standards **before** seeking the authority to require remote sellers to collect sales tax on their behalf. Any attempt by the states to overturn the

Quill decision and the Commerce Clause proscriptions against undue burdens on interstate commerce by means of an act of Congress requires a rebalancing of the new authority. **No greater disaster could evolve in this debate than for a mandatory duty to collect sales tax to be imposed on out-of-state merchants before the states have simplified their sales and use tax provisions in a uniform manner.** The careful balance of power that currently exists would be upset if states were allowed to require out-of-state merchants with no physical contacts in the state to collect sales tax in the state **before** the states simplify their tax systems and Congress deems the simplification sufficient to allow this authority.

What should be done about the web of telecommunications taxes?

Telecommunications is fundamental to electronic commerce. Without telecommunications there is no electronic commerce. Taxes imposed in this area are the most complex, multi-layered and unclear of any transactions taxes. The Committee on State Taxation study of telecommunications taxes demonstrates this clearly. As many of these taxes are imposed on the users of telecommunications, the users of electronic commerce are burdened. Electronic commerce pays the price, and suffers the consequences, of excessive, complex and uncertain taxes. **No simplification of taxation of electronic commerce, including Internet, catalogue sales, and other businesses at least in part conducted by telephone or other telecommunications, is complete without the included rationalization of telecommunications taxes.** Telecommunications taxes need not be included with other transactions taxes, but there is no rationale for excluding telecommunications taxes from any streamlined processes.

What are the Constitutional issues at hand?

Despite the insistence of some of the parties involved, this issue is not a question of who should control the future of state tax schemes. States should control taxing authority within their borders. Rather, **this is clearly an issue of the states trying to expand their taxing power under the U.S. Constitution, via the Compact Clause, without dramatically simplifying their currently difficult (particularly for small companies) web of conflicting sales tax laws and rules.** What the states have actually asked for is a right to require remote merchants to collect and remit sales taxes. **This is an expansion of power.** If Congress considers passing legislation that grants this power shift to the states, then the legislation must include simplification standards for the states to meet before they can return to Congress seeking the ability to tax beyond their jurisdiction.

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