The Florida Senate

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Committee on Finance and Taxation Senator James E. "Jim" King, Jr., President

STREAMLINED SALES TAX PROJECT - IMPLEMENTING LANGUAGE

SUMMARY

The Streamlined Sales Tax Project is an effort by state governments, with input from local governments and the private sector, to simplify and modernize sales and use tax collection and administration. The Project's proposals incorporate uniform definitions within tax bases, simplified audit and administrative procedures, and emerging technologies to substantially reduce the burdens of tax collection. The goal of the Streamlined Sales Tax Project is to design and implement a simplified sales tax collection system that can be used by traditional brick-and-mortar vendors and vendors involved in e-commerce. In 2001, the Florida Legislature passed chapter 2001-225, Laws of Florida, which among other things, created the Simplified Sales and Use Tax Administration Act (Act), authorizing Florida to participate in the next phase of discussions with other states for the purposes of developing the Project. There are 39 states involved in the project. The adoption of the Act was the first step towards adoption of the Streamlined Sales and Use Tax Agreement (Agreement) in Florida. On November 12, 2002, representatives from 33 states and the District of Columbia voted to approve the multi-state Agreement to simplify the nation's sales tax laws by establishing one uniform system to administer and collect sales taxes. Florida must make the changes necessary to comply with the Agreement in the upcoming Legislative session in order to be included in the governing states that will administer the Agreement.

BACKGROUND

Florida relies heavily on its 6 percent sales and use tax. In fiscal year 2001-2002, sales and use tax collections accounted for 73% of General Revenue and over 40% of all tax revenues. Forty-five states and the District of Columbia impose sales and use taxes. States that do not have a personal income tax – Florida, Nevada, South Dakota, Tennessee, Texas, Washington and Wyoming - rely most heavily on sales tax collections.

Sales tax is imposed, at the time of purchase, primarily on taxable, tangible personal property. To provide a level playing field between in-state retailers and out-of-state vendors, states impose "use" taxes. Use taxes require residents who purchase taxable goods in another state to pay the equivalent of a sales tax in their home state. The use tax preserves a key principle of the sales tax - that the tax is due in the state where the product is used or consumed, not necessarily where it is purchased. Use taxes are difficult for states to enforce, because they must rely on out-of-state vendors to collect the tax money or purchasers must remit the tax themselves. Out-of-state vendors, not wanting to be tax collectors for states and local governments, argue that states have no jurisdiction over them.

States' attempts to enforce the use tax by requiring out-of-state firms to collect taxes from customers led to the 1967 U.S. Supreme Court decision, *National Bellas Hess, Inc. v. Illinois, 386 U.S. 753 (1967).* In that case, the court ruled that states lack the authority to compel out-of-state firms to collect use taxes unless those firms have "nexus" in the state. Nexus was defined by physical presence, having an office or store, owning property or employing workers in a state. The court decision was rooted in the Commerce Clause of the U.S. Constitution, which gives Congress jurisdiction over issues involving interstate commerce. The Court said that imposing a tax collection obligation on out-of-state sellers would impose an "undue burden" on interstate commerce. *National Bellas Hess* was reaffirmed by the U.S. Supreme Court in *Quill Corp. v. North Dakota, 112 S.CT. 1904 (1992).* In the *Quill* decision, the Court cited the complexity and fluidity of sales tax structures from state-to-state as an undue burden on remote sellers, and thus on interstate commerce.

At the time of the *Quill* case, most remote sales were made through catalogs. A 1994 report by the federal Advisory Commission on Intergovernmental Relations estimated that states lost about $3.3 billion in uncollected use taxes in 1994 on catalog or telephone sales. The report estimated the growth in mail-order sales at about 5 percent per year. Although states were concerned about the revenue loss from mail-order sales, $3.3 billion out of a total of $120 billion in state sales taxes was viewed as a relatively small problem.[1] The advent of e-commerce has caused a dramatic increase in remote sales. According to research done by Nielson//Net Ratings[2] and NUA Internet Surveys[3], some facts about the internet are:

- Sixty percent of U.S. households have internet access
- Ninety-three percent of internet users have made on-line purchases
- Retail e-commerce sales in 3rd Quarter 2002 were $11.1 billion, up 34.3% from 3rd Quarter 2001

In response to the Internet explosion, Congress enacted the Internet Tax Freedom Act (ITFA) in October 1998. This legislation called for a 3-year moratorium, from October 1, 1998 to October 21, 2001, on state and local taxes on Internet access, unless such tax was generally imposed and actually enforced before October 1, 1998. The ITFA specifically preserves state and local taxing authority. Purchases made via the Internet, if otherwise taxable, are still taxable when purchased over the "net". On October 21, 2001, the ITFA expired. On November 28, 2001, Congress and the President extended the ITFA to November 1, 2003.

The issue of sales and use taxes on e-commerce is important to the states for three main reasons:

- The expected growth in e-commerce points to an increasing number of transactions on which sales and use taxes will not be collected, resulting in sales tax revenue losses for states and local governments;
- Since remote sellers do not have to collect sales and use taxes, except in states where they have "nexus", they enjoy a competitive advantage over "Main Street" businesses; and
- Because of loopholes for on-line retailers, consumers who can afford access to the internet escape paying sales and use taxes while forcing those without access to shoulder a heavier burden of the sales tax.[4]

The inability of states to collect existing online sales taxes is estimated to have a dramatic effect on both state and local revenues. A recent University of Tennessee study commissioned by the Institute for State Studies found that state and local governments could lose $13.3 billion in 2001, $45.2 billion in 2006 and as much as $54.8 billion in 2011 because of this problem. In Florida alone, the loss could be as high as $932.2 million in 2001, $3.2 billion in 2006 and $3.9 billion in 2011.[5]

Source: National Governors Association Web-site: http://www.nga.org/nga/salestax/

Currently, America's sales and use tax system, with roughly 7,500 state and local taxing jurisdictions across the nation, is antiquated, complex, and cumbersome to businesses in today's new economy. One of the problems with so many taxing jurisdictions is that they often have different laws or definitions of what is taxable. That arrangement makes it very difficult for remote retailers, such as mail order companies and e-commerce companies, to collect and remit sales taxes at varying rates to different state and local governments.

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[1] Scott Mackey, "Can the Sales Tax Survive Cyberspace?", State Legislatures, December, 1999.
[2] http://www.nua.net
[3] http://www.nielsen-netratings.com
[4] Graham Williams, "Streamlined Sales Tax for the New Economy", National Conference of State Legislatures, Nov./Dec. 2000, Vol. 8, No. 44.
[5] Donald Bruce and William F. Fox, Center for Business and Research, University of Tennessee, "State and Local Sales Tax Revenue Losses from E-Commerce: Updated Estimates", September, 2001.

Serious consideration of utilizing modern technology coupled with substantial and substantive law changes to address these e-commerce issues began with the National Tax Association's Communications and Electronic Commerce Tax Project. In that process, state and local government representatives suggested that tax compliance software, in coordination with systems maintained by financial intermediaries, could solve many of these problems. Out of this project emerged the National Conference of State Legislatures (NCSL) Executive Committee's Task Force on State and Local Taxation of Telecommunications and Electronic Commerce. In coordinated efforts with governors and tax administrators, NCSL formed the Streamlined Sales Tax Project in March 2000. The goal of the streamlined project is to design and implement a simplified sales tax collection system that can be used by traditional brick-and-motor vendors and vendors involved in e-commerce. In response to this effort, the Florida Legislature passed chapter 2000-355, Laws of Florida, creating s. 213.27(9), F.S., giving the Department of Revenue authority to enter into contracts with public or private vendors to develop and implement a voluntary system for sales and use tax collection and administration.

On January 27, 2001, the NCSL Executive Committee unanimously endorsed the Uniform Sales and Use Tax Administration Act and the Streamlined Sales Tax Agreement, as amended and approved by the Executive Committee's Task Force on State and Local Taxation of Telecommunications and Electronic Commerce. States that adopted the Uniform Sales and Use Tax Administration Act or had their governors issue executive orders or similar authorizations were authorized to participate in the next phase of discussions with other states for the purpose of developing a multi-state, voluntary, streamlined system for the collection and administration of state and local sales and use taxes. In 2001, the Florida Legislature passed chapter 2001-225, Laws of Florida, which among other things, created the Simplified Sales and Use Tax Act, authorizing Florida to participate in the next phase of discussions with other states for the purposes of developing the Project.

There are thirty-nine states and the District of Columbia involved in the Project. Thirty-four states and the District of Columbia had their legislatures enact enabling legislation. These states make up the Streamlined Sales Tax Implementing States (SSTIS) On November 12, 2002, the Streamlined Sales Tax Agreement (Agreement) was approved at a meeting of the SSTIS held in Chicago, Illinois.

Source: National Governors Association Web-site:
http://www.nga.org/nga/salestax/

The SSTIS met over the past year to review, debate, and approve provisions in the Agreement proposed by the Streamlined Sales Tax Project. The Project conducted its work through a steering committee with co-chairs, four work groups, and a number of sub-groups. Project participants are generally state revenue department administrators in addition to representatives from state legislatures and local governments. Businesses, including national retailers, trade associations, manufacturers, direct marketers, technology companies, and others, have actively participated in the Project.

METHODOLOGY

Senate Finance and Taxation Committee staff attended many of the Streamlined Sales Tax Implementing States (SSTIS) meetings held over the past year as designee for Senator Ken Pruitt. The Florida Department of Revenue also had a representative at the SSTIS meetings and Project meetings. A working group was formed with Senate Finance and Taxation staff and the Department of Revenue to draft implementing legislation.

FINDINGS

The Streamlined Sales Tax Project is an effort created by state governments, with input from local governments and the private sector, to simplify and modernize sales and use tax collection and administration. The Project proposes that states change their sales and use tax laws to conform to the simplifications as proposed by the project. Thus, the simplifications would apply to all sellers. Participation in the Streamlined Sales Tax System is voluntary for sellers who do not have a physical presence or "nexus" within a state unless Congress chooses to require collection from all sellers for all types of commerce. Also, registration by sellers to voluntarily collect sales and use taxes will not infer that the business must collect business activity taxes, such as corporate franchise or income tax.

As of October 2002, thirty-four states and the District of Columbia have enacted the Act. These states are considered the "Implementing States" and have approved provisions contained within the initial Agreement. Florida is one of the Implementing States. The key features found within the Agreement include:

- Uniform definitions within tax laws. Legislatures still choose what is taxable or exempt in their state. However, participating states will agree to use the common definitions for key items in the tax base and will not deviate from these definitions.
- Rate simplification. States will be allowed one state rate and a second state rate in limited circumstances. Local jurisdictions will be allowed one local rate.
- State tax administration of all state and local taxes. Businesses will no longer file tax returns with each local government where it conducts business in a state. States will be responsible for the administration of all state and local taxes and the distribution of the local taxes to the local governments. State and local governments must have common tax bases.
- Uniform sourcing rules. The states will have uniform and simple rules as to how they will source transactions to state and local governments.
- Simplified exemption administration for use-and entity-based exemptions. Sellers are relieved of the "good faith" requirements that exist in current law and will not be liable for uncollected tax. Purchasers will be responsible for paying the tax, interest and penalties for claiming incorrect exemptions.
- Uniform audit procedures.
- State funding of the system. To reduce the financial burdens on sellers, states will assume responsibility for funding some of the technology models.

When at least 10 states representing 20 percent of the U.S. population have amended their laws to comply with the Agreement, administration of the Agreement will switch to the governing states.

The governing board will be comprised of representatives of each member state. Each member state is entitled to one vote on the governing board. The governing board is responsible for interpretations of the Agreement, amendments to the Agreement, and issue resolution. A State and Local Government Advisory Council and a Business and Taxpayer Advisory Council from the private sector will advise the governing board.

RECOMMENDATIONS

The Florida Legislature enacted chapter 2001-225, Laws of Florida, which created the Simplified Sales and Use Tax Act, authorizing Florida to participate in the next phase of discussions with other states for the purpose of developing the Streamlined Sales Tax Project. Florida participated by being a Streamlined Sales Tax Implementing States (SSTIS) member. It is the recommendation of the Senate Finance and Taxation Committee that Florida takes the steps necessary to be in substantial compliance with provisions of the Streamlined Sales and Use Tax Agreement as adopted by the SSTIS on November 12, 2002. This will require legislation to be filed during the 2003 Legislative Session to amend chapter 212, Tax on Sales, Use, and Other Transactions. The implementation of the Streamlined Sales and Use Tax Agreement will significantly reduce the costs of collecting and remitting state and local sales taxes. It could ultimately level the playing field between e-commerce and "Main Street" businesses and provide Florida with a more stable sales and use tax base.